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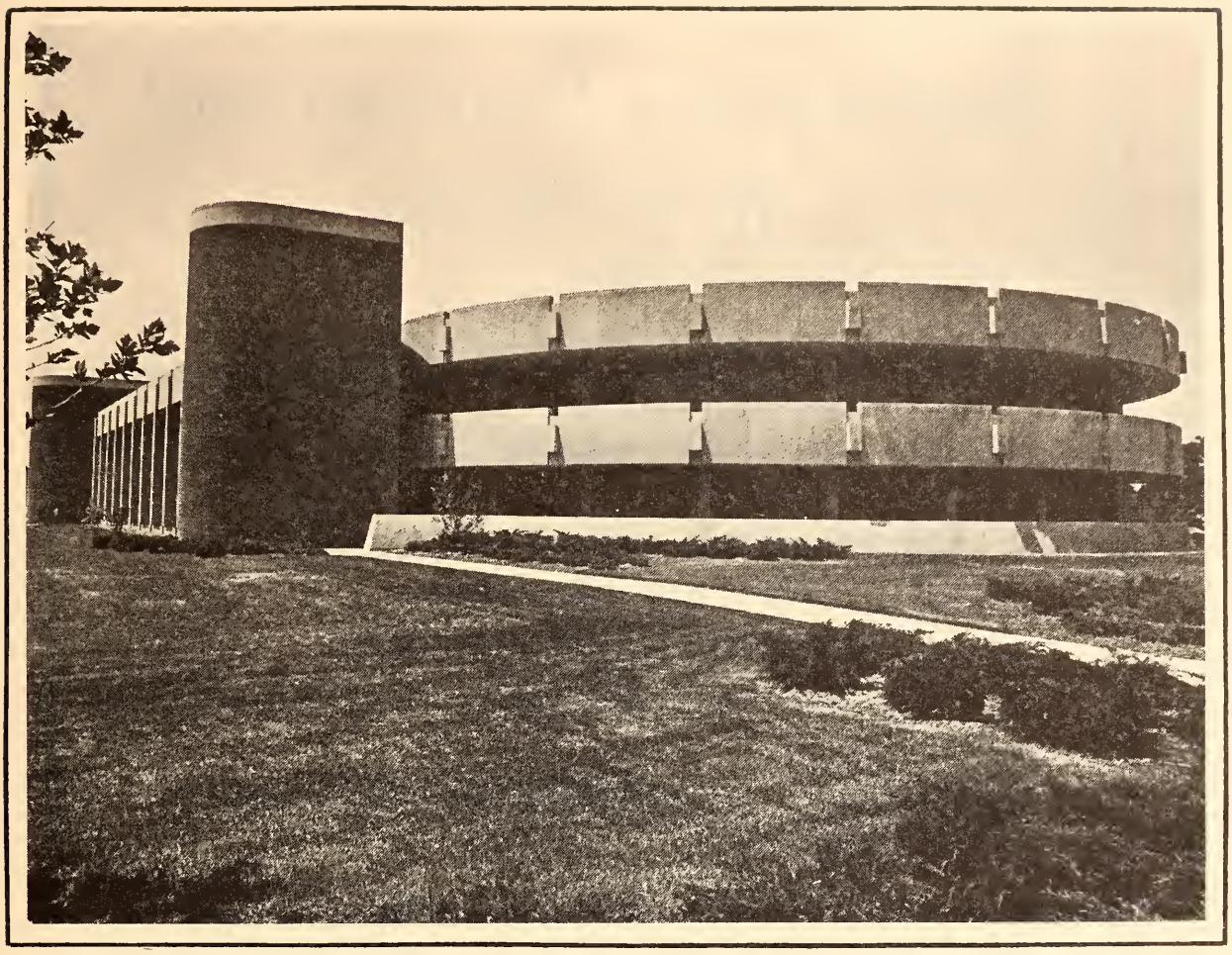

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Regulation of Not-For-Profit Corporations in Indiana

John T. Baker*

I. Introduction

There were approximately twenty-five thousand nonprofit corporations incorporated in the state of Indiana as of 1984.[1] These corporations ranged in size from the small family foundation with a few thousand dollars in assets to the Lilly Endowment,[2] from small health care facilities to large metropolitan hospitals, from nursery schools to universities. Given the extensive presence of nonprofit corporations in the state, the activities carried on by their managers have a significant impact on the cultural, economic, social, and intellectual lives of citizens of Indiana.

The one common element among these nonprofit corporations is that they were formed under the Indiana Not-For-Profit Corporation Act or its predecessors.[3] Moreover, many of these nonprofits are also exempt from state and federal taxation.[4] The underlying rationale for

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[1]Telephone interview with Judy Webb, Filing Clerk for the Legal Department of the Office of the Secretary of State of Indiana (June 17, 1984).

[2]The Lilly Endowment is one of the largest private endowments in the United States.

[3]Ind. Code § 23-7-1.1-1 to -66 (1982 & Supp. 1985).

[4]Property tax exemptions for Indiana's nonprofit corporations are provided in Ind. Code § 6-1.1-10-16 (1982) (buildings and land used for educational, literary, scientific, religious, or charitable purposes); *id.* § 6-1.1-10-18 (1982) (nonprofit corporations supporting fine arts); *id.* § 6-1.1-10-18.5 (Supp. 1985) (nonprofit corporation property used in operation of health facility, home for the aged); *id.* § 6-1.1-10-21 (1982) (churches or religious societies); *id.* § 6-1.1-10-23 (1982) (fraternal benefit associations); *id.* § 6-1.1-10-25 (Supp. 1985) (miscellaneous organizations).

Gross income tax exemptions for nonprofit corporations in Indiana are located at Ind. Code § 6-2.1-2-20 (1982) (religious, charitable, scientific, literary, educational, or civic organizations); *id.* § 6-2.1-3-21 (Supp. 1985) (fraternal or social organizations, business leagues, contributions, fees, and receipts from the sale of intangible property or from trade shows or exhibitions; *id.* § 6-2.1-3-22 (1982) (hospitals, labor unions, religious institutions, schools, pension trusts).

Indiana nonprofit corporations are exempt from gross retail tax under Ind. Code § 6-2.5-5-25 (1982) (acquisitions by nonprofit organizations); *id.* § 6-2.5-5-26 (1982) (sales

both the state and federal tax exemptions is that nonprofits constitute a vehicle used by people to create and allocate resources that are not created or allocated by private market sector organizations or by the government.[5]

Their existence appears quite important to many people.[6] Because of the perceived importance of these organizations in a democratic society, government has provided incentives to stimulate their growth and development. The incentives provided by state government include the availability of the corporate form and income, property, and sales tax exemptions under appropriate circumstances.[7] At the federal level, the prime incentives are exemptions from federal income taxation and the tax deduction for donors to qualified nonprofit corporations.[8]

Attempting to justify these governmental incentives is significantly harder than the description of their existence. Clearly, there is a well-established notion that nonprofits advance the public good.[9] Charitable foundations provide resources to beneficiaries which would, in many instances, otherwise have to be provided by government. Scientific organizations, through experimentation, are often able to produce new medical and industrial products for future mass production and distribution by private industry or government. Educational institutions foster academic achievement. Social organizations serve as mediating institutions for individuals who daily must confront the large, impersonal institutions of business and government. Trade associations permit entrepreneurs to further their interests collectively. The activities of most of these organizations are carried out by nonprofit corporations.[10] Yet, nothing in the delineation of the activities pursued by nonprofit corporations explains why the activity is carried out by a nonprofit corporation as opposed to a for-profit corporation or governmental agency. An explanation of

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by nonprofit organizations). Some nonprofit corporations are also exempt from the Indiana intangibles tax. *Id.* § 6-5.1-5-1 (1982) (religious, charitable, or educational associations). There is, additionally, an exemption from the adjusted gross income tax. *Id.* § 6-3-2-2.8 (Supp. 1985). Finally, some nonprofits are exempt from the state employment tax. *Id.* § 22-4-8-2(j) (1982). Federal income tax exemptions are available to nonprofit corporations under the Internal Revenue Code. *See* I.R.C. § 501(c) (1982).

[5]*See generally* B. WEISBROD, THE VOLUNTARY NONPROFIT SECTOR: AN ECONOMIC ANALYSIS (1977).

[6]*See* B. WEISBROD, TOWARD A THEORY OF THE VOLUNTARY NON-PROFIT SECTOR IN A THREE-SECTOR ECONOMY (1975).

[7]*See supra* note 4.

[8]*See* I.R.C. § 170 (1982). The amount allowed for charitable contributions is deducted in arriving at one's adjusted gross income. I.R.C. § 62 (4) (1982).

[9]*See generally* G. MCCONNELL, THE PUBLIC VALUE OF THE PRIVATE ASSOCIATION IN VOLUNTARY ASSOCIATIONS 147-48 (1969); Karst, *The Efficiency of the Charitable Dollar: An Unfulfilled State Responsibility,* 73 HARV. L. REV. 433 (1960).

[10]Hansmann, *The Role of Nonprofit Enterprise,* 89 YALE L.J. 835, 845 (1980).

the conceptual justification for nonprofit corporations is beyond the scope of this Article.[11]

While a conceptual foundation is emerging, there is still very little in the way of case law, legislation, or legal literature to describe the extent to which social expectations for these corporations have been or should be translated into legal rules. At the same time, there has been a proliferation of legal literature examining various aspects of corporate

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[11]In recent years, some scholarly attention has been devoted to this issue. In his article on nonprofit corporations, Professor Henry Hansmann attributed the existence of nonprofit corporations to "contract failure," a condition that exists when "consumers [are] incapable of accurately evaluating the goods promised or delivered," thereby making "ordinary contractual services inadequate to provide the purchaser of the service with sufficient assurance that the service was in fact performed as desired." *See* Hansmann, *supra* note 10, at 843-45. Hansmann defined "patrons" as all who transfer money to nonprofit corporations whether they are donors or customers. *Id.* at 841. Hansmann asserted that when patrons who are customers find themselves in the position of being unable to evaluate the producer's output, "[they] might be considerably better off if they deal with nonprofit producers rather than with for-profit producers. The nonprofit producer, like its for-profit counterpart, has the capacity to raise prices and cut quality . . . without much fear of customer reprisal; however, it lacks the incentive to do so because those in charge are barred from taking home any resulting profits." *Id.* at 844. Hansmann's primary emphasis is on the limitations of the private market in providing particular services.

Other theorists have approached the issue from a governmental perspective. Perhaps the clearest theoretical explanation of the existence of nonprofit corporations because of "government failure" is provided by Professor Burton Weisbrod. *See* B. WEISBROD, THE VOLUNTARY NONPROFIT SECTOR: AN ECONOMIC ANALYSIS (1977). Weisbrod assumed that different citizens want public goods to varying extents, or, in the language of economics, have different demand functions for public goods. *Id.* at 175. He also assumed that public goods may be provided by government, by private nonprofit organizations, and even by commercial enterprises when the demand for the public good (*e.g.*, clear air) may be satisfied by private-good substitutes (*e.g.*, air filters). *Id.* at 179. Weisbrod examined the manner by which the government decides how much of a public good to produce. He assumed that for each level of output there is a corresponding level of costs to be paid in taxes. In addition, Weisbrod stated that each citizen has a different demand function; each citizen will be prepared to pay in taxes for different amounts of the goods in question. *Id.* at 175. Weisbrod concluded that government will produce to the level determined by the median voters' demand schedules, to the point where there will be as many voters who want more of that public good as there are voters who want less. *Id.* Weisbrod, of course, recognized that this is not the way that governments really determine the level of public expenditures, although the bargaining process of democratic politics may come close to it. *Id.* at 177. The actual level at which government sets the public expenditure on that service is ultimately irrelevant to Weisbrod's argument. *Id.* at 177. As long as the assumption that different voters have different demand functions remains true, there will always be some citizen-voters who are under-satisfied with the level of production of the public good, and some citizen-voters who are over-taxed by that level. *Id.* at 178. The over-taxed citizens do not have many options. They may be able to exert political pressure to lower the output-tax level. But if they fail, they can only tolerate it or emigrate from the jurisdiction. *Id.* at 182. The under-satisfied citizens, however, also

governance of the business or for-profit corporation.[12] It seems, therefore, that some insight into the issue of governing the nonprofit corporation may be gained from examining these legal developments and writings. Consequently, the analysis in this Article will draw upon these sources. This analysis first briefly describes the ways in which nonprofit corporations in Indiana are regulated. Second, it examines the comparative strengths and weaknesses of Indiana's regulatory scheme from the standpoint of accountability. Third, the nonprofit corporation acts of New York and California are considered. Finally, this Article suggests some proposals for strengthening the Indiana Not-For-Profit Corporation Act. The Appendix to this Article contains a proposal for a new statutory scheme for Indiana nonprofit corporations.

II. The Indiana Not-For-Profit Corporation Act

Indiana adopted the present version of its Not-For-Profit Corporation Act in 1971.[13] The Act defines a not-for-profit corporation as "any corporation which does not engage in any activities for the profit of its members and which is organized and conducts its affairs for purposes other than the pecuniary gain of its members."[14] A nonprofit corporation must have a nonprofit purpose and must not distribute its assets or income to its members, including directors and officers.[15] An Indiana nonprofit corporation is also prohibited from issuing stock or dividends.[16]

Nonprofit corporations must have members, who may comprise one or more classes as provided for in the certificate of incorporation.[17] All members are immune from liability for corporate debts except to the extent of any unpaid portion of membership dues.[18] The Act requires a quorum of a majority of the membership to transact business at a

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have the option of supplementing the public provision (which in the limiting case can be zero) by voluntary provision which must be nonprofit because the theory is dealing with goods that cannot be made the subject of market transactions. Thus, Weisbrod concluded that private nonprofits will tend to supply the sorts of public goods for which there is not yet a demand from the majority of citizens or which a majority of citizens are only prepared to supply and pay for in taxation in what a minority consider inadequate quantities. *Id.*

[12]*See, e.g.*, Black, *Shareholder Democracy and Corporate Governance*, 5 Sec. Req. L.J. 291 (1978); Hershman, *Liabilities and Responsibilities of Corporate Officers and Directors*, 33 Bus. Law 263 (1977); Schwartz, *Corporate Responsibility in the Age of Aquarius*, 109 Tr. & Est. 1004 (1970).

[13]Act of Apr. 16, 1971, Pub. L. No. 364, §§ 1-4, 1971 Ind. Acts 1499 (codified at Ind. Code §§ 23-7-1.1-1 to -66 (1982 & Supp. 1985)).

[14]Ind. Code § 23-7-1.1-2(d) (Supp. 1985).

[15]*Id.* § 23-7-1.1-1 to -66 (1982 & Supp. 1985)).

[16]*Id.* § 23-7-1.1-7.

[17]*Id.* That Indiana nonprofit corporations must have members is implicit in the definition of "not-for-profit." *See id.* § 23-7-1.1-2(d) (Supp. 1985).

[18]*Id.* § 23-7-1.1-7 (1982).

meeting unless otherwise specified in the articles of incorporation or the bylaws.[19] Proxy voting is permitted and, if provided for by the certificate of incorporation, members may use cumulative voting.[20]

The Indiana Act promotes strong boards of directors for nonprofit corporations. The Act provides that the board of directors shall manage the affairs of the corporation.[21] It contains no express provisions for alternative arrangements which would allow for greater membership control. The Act does, however, permit delegation of the board's authority to an executive committee consisting of at least two members of the corporation.[22]

The board of directors for a nonprofit corporation is normally not subject to personal liability for corporate actions.[23] However, a board member who incurs expenses in connection with the defense of any civil action involving the corporation may be indemnified provided she is not found guilty of negligence or misconduct in the performance of her duties. Conversely, directors who vote for or concur in certain proscribed corporate actions are jointly and severally liable for all resulting damages. Such proscribed actions include false statements in annual or special reports, improper distributions, and improper loans.[24] Directors held liable for violations may obtain contribution from other directors who have voted for or concurred in the action.[25]

Under the Indiana Act, nonprofit corporations may not issue shares.[26] Members may lend or advance money to the corporation. Those contributions are redeemable for the total amount loaned plus a reasonable interest.[27]

Mergers and consolidations of nonprofit corporations are permitted under the Act.[28] There is also a provision permitting foreign corporations to qualify to conduct local activities.[29] Finally, upon dissolution of the corporation and satisfaction of creditors' claims, the statute provides the priority of distribution of the nonprofit corporation's assets: (1) repayment of amounts advanced or loaned to the corporation by members; (2) transfers of the remaining assets to another nonprofit organization having a purpose substantially similar to that of the dissolving corporation; (3) escheat to the state of all remaining assets.[30]

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[19] *Id.* § 23-7-1.1-9(g) (Supp. 1985).
[20] *Id.* § 23-7-1.1-9(f).
[21] *Id.* § 23-7-1.1-10(a).
[22] *Id.* § 23-7-1.1-10(h).
[23] *See* IND. CODE § 23-7-1.1-4(b)(9) (1982).
[24] *Id.* § 23-7-1.1-64(b).
[25] *Id.* § 23-7-1.1-62.
[26] *Id.* § 23-7-1.1-7.
[27] *Id.*
[28] *Id.* § 23-7-1.1-41.
[29] *Id.* § 23-7-1.1-48.
[30] *Id.* § 23-7-1.1-33(b)(3)(E) (Supp. 1985).

III. Accountability

When referring to organizations that hold and manage resources on behalf of others, accountability means the ability of those on whose behalf the resources are being managed, the constituents, to establish and change the goals of the organization. Accountability mechanisms are consequently necessary to measure the effectiveness of the organization's managers in their efforts to achieve the nonprofit's goals.[31] More concretely, in the context of this Article, if one of the goals in regulating nonprofit corporations is to impose accountability upon the managers of those corporations, then the constituencies of nonprofits need to be specifically identified.

The first constituency of all nonprofit corporations is the electorate. Both federal and state governments sacrifice revenue which would otherwise be generated through the taxing system because the income of qualified nonprofits is exempt from federal and, in most jurisdictions, state taxation.[32] The electorate is entitled to some indication of the effectiveness of these organizations, and should also consider the desirability of promoting the social welfare through this type of subsidy.

Two other constituencies of nonprofit corporations also have the capacity to effect goal changes as well as managerial and operating changes. The nonprofit's *donors* may threaten to discontinue providing support to a particular nonprofit unless that corporation modifies or expands its goals.[33] Likewise, the nonprofit's *members* may express their disagreement with the corporation's goals by resigning.[34] Finally, *beneficiaries* may also have an impact upon the organization's goals. Their failure to use the services of a nonprofit or threats to refuse services unless the corporation's goals are changed may, under particular circumstances, prove effective.[35] Through these constituencies, accountability serves as a mechanism for goal change as well as a measure for the effectiveness of goal achievement.

The types of accountability mechanisms generally associated with corporations may be broadly classified as structural mechanisms, adjudicative mechanisms, and market forces. Structural accountability mech-

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[31]*See* J. Becker, *Accountability: A New Form of Tease, in* Accountability: A State, A Process, or A Product (ed. W.J. Gephart) 1 (1975).

[32]*See supra* note 4. *See also* Bittker & Rahdert, *The Exemption of Nonprofit Organizations from Federal Income Taxation,* 85 Yale L.J. 299 (1976).

[33]Professor Albert Hirshman argues that stockholders, customers, or members of organizations have three mechanisms available to them to communicate satisfaction or dissatisfaction with the organization: exit, voice, and loyalty. *See* A. Hirschman, Exit, Voice and Loyalty, 4 (1970). Clearly, discontinuing financial or voluntary labor support to the nonprofit corporation is a communication device that Hirshman would call "exit."

[34]*Id.*

[35]*Id.*

anisms include statutes, administrative regulations, and the organizations' constitutions, articles of incorporation, and bylaws.[36] Accountability through adjudication means that some constituents of the organization have a right to resolve issues of goal definition, operating procedure, managerial authority, and other areas of organizational status by resort to litigation.[37] Finally, accountability through the market in the case of nonprofits means the organization's ability to raise funds, acquire and retain members, and, where applicable, attract customers.[38] For comparative purposes, nonprofit corporation statutes from other jurisdictions will be considered.

A. Structural Mechanisms

The primary structural mechanism for promoting the accountability of nonprofits in Indiana is the Indiana Not-For-Profit Corporation Act.[39] This Act promotes accountability to the state, to donors, to members, and to beneficiaries by requiring a statement of organizational purposes,[40] periodic reports,[41] and by granting state officials the right to inspect corporate books and records.[42] The Act also defines a number of standards of conduct for officers, directors, and the corporation itself.[43]

1. Accountability at the Formation Stage.—Accountability is achieved

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[36]Structural accountability simply means formal rules that should govern the conduct of the corporation's managers. These rules may be adopted by the government, as in the case of nonprofit corporation statutes, or they may be adopted by the members of the organizations, as is the case with the corporation's articles of incorporation and by-laws.

[37]The best example of this type of accountability for nonprofit corporations is the member's derivative action. *See, e.g.,* N.Y. NOT-FOR-PROFIT CORP. LAW § 720(b)(3) (McKinney 1970).

[38]Professor Hansmann divides nonprofits into two categories: donative nonprofits (those that "receive most or all of their income in the form of grants or donations") and commercial nonprofits (those that "receive the bulk of their income from prices charged for their services"). Hansmann, *supra* note 10, at 840. Clearly there is, in the traditional use of the term, a *market* for the goods and services of commercial nonprofits. *See, e.g.,* E. KAITZ, PRICING POLICY AND COST BEHAVIOR IN THE HOSPITAL INDUSTRY (1968); S. LAW, BLUE CROSS: WHAT WENT WRONG? (1974); M. MENDELSON, TENDER LOVING GREED (1974); Newhouse, *Toward a Theory of Non-Profit Institutions: An Economic Model of a Hospital,* 60 AMER. ECON. REV. 64 (1970). There is far less understanding of the "market" for donations to and members of donative nonprofits. *But see* K. BOULDING, THE ECONOMY OF LOVE AND FEAR (1973); Buchanan, *An Economic Theory of Clubs,* 32 ECONOMICS 1-14 (1965); Nelson, *Economic Factors in the Growth of Corporate Giving,* NATIONAL BUREAU OF ECONOMIC RESEARCH AND RUSSELL SAGE FOUNDATION (1970).

[39]IND. CODE § 23-7-1.1-1 to -66 (1982 & Supp. 1985).

[40]*Id.* § 23-7-1.1-18 (Supp. 1985).

[41]*Id.* § 23-7-1.1-36.

[42]*Id.*

[43]*See id.* §§ 23-7-1.1-13, -11, -15, -36, and -61.

in part through an incorporation process that forces the original members of the corporation to disclose the corporation's purposes and the procedures under which it will operate.[44] This information is available to officials of the state, potential members, donors, and beneficiaries. The corporate purpose must be included in the proposed articles of incorporation, along with a corporate name, the duration of the corporation's existence, its post office address, and its principal office. In addition, the articles of incorporation disclose the name and address of the nonprofit's resident agent, the number of corporate directors, the names and addresses of the initial board of directors and the incorporators, a statement of membership rights, and a statement concerning the property that will be owned by the corporation when it begins business.

Approval of the proposed articles of incorporation in Indiana appears to be largely a formality. Indiana Code section 23-7-1.1-19 requires the secretary of state to approve the proposed articles of incorporation if he finds that they "conform to law."[45] If this langauge means that the articles of incorporation must conform to the express formal requirements of the statute, it would appear that the secretary has no discretion to withhold approval once all statutory requirements are met.

Indiana Code section 23-7-1.1-63, however, contains significantly different language: "When any corporation . . . offers for filing articles of incorporation, . . . it shall be the duty of the secretary of state to ascertain whether the corporation is a bona fide not-for-profit corporation."[46] This language may mean that the secretary of state has discretion to conclude that the proposed corporation's purposes are inconsistent with one or more public policies of Indiana; that the proposed corporation has insufficient assets to accomplish its mission; or even that the individuals who will serve as managers of the corporation are, for some reason, unqualified. Unfortunately, the language of Indiana Code section 23-7-1.1-63 is ambiguous as to what the "bona fide" test is, as well as with respect to which corporations might be subject to the test.[47] On its face, Indiana Code section 23-7-1.1-63 applies only to incorporation by an existing corporation. Thus, the section could be read as making the "bona fide" test applicable only to nonprofits seeking to reincorporate or to nonprofits acting as incorporators of new nonprofits.[48]

Such an interpretation, however, appears to be contrary to that given

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[44]IND. CODE § 23-7-1.1-18 (Supp. 1985).

[45]*Id.* § 23-7-1.1-19 (1982).

[46]*Id.* § 23-7-1.1-63.

[47]IND. CODE § 23-7-1.1-2(a) defines the term "corporation" as "any corporation *formed under this chapter.*" IND. CODE § 23-7-1.1-2(a) (Supp. 1985) (emphasis added).

[48]Corporations are specifically authorized to act as incorporators of a nonprofit corporation. IND. CODE § 23-7-1.1-16 (1982).

in *Lemmons & Co. v. Indiana Cooperative Hauling Association*.[49] In that case, the petitioner appealed from the Public Service Commission's dismissal of a complaint alleging that the respondents were operating as motor carriers in violation of the Commission's regulations. The respondent filed a motion to dismiss based upon a statutory exemption for nonprofit corporations from regulation under the Indiana Motor Carrier Act.[50] The respondent's motion was granted after the Commission determined the respondent's nonprofit status was based solely upon the fact of its incorporation under the Indiana Not-For-Profit Corporation Act. The court of appeals affirmed the dismissal and stated that the Commission had the right to rely upon the determination of nonprofit status by the secretary of state as evidenced by the respondent's certificates of incorporation.[51] In so holding, the court relied upon Indiana Code section 23-7-1.1-63: "Only after the secretary of state has determined that an *organization* is a bona fide nonprofit *organization* can that organization be incorporated under the Not-For-Profit Corporation Act."[52] The *Lemmons* court's reading of the section is questionable with respect to which corporations might be subject to the "bona fide" test, especially in light of the actual statutory language. This case does suggest, however, that courts may be willing to allow the secretary of state greater discretion in rejecting proposed articles of incorporation than the literal language of sections 23-7-1.1-19 and 23-7-1.1-63 would permit. Paradoxically, while the *Lemmons* case may indicate that the secretary can take a more discretionary role in determining whether or not an organization may properly incorporate as a nonprofit, the case also appears to limit severely the avenues of accountability once the nonprofit is formed. It appears to exclude from the accountability process challenges from outsiders whose own interests might be affected.

Indiana's statutory requirements for incorporation are fairly typical.[53] Like most state nonprofit corporation acts, the Indiana Act establishes one unitary standard for incorporation regardless of the activity to be undertaken. The Act provides for one method of incorporation by organizations as diverse as charities, churches, and fraternities. All of its provisions apply with equal force to all of these organizations. It is not at all clear that this is the best way to assure accountability to the constituents of these diverse organizations. Clearly, some of the statutory provisions needed for some types of nonprofits are of little use for

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[49]175 Ind. App. 654, 373 N.E.2d 891 (1978).

[50]IND. CODE § 8-2-7-3(g) (1982).

[51]175 Ind. App. 654, 657, 373 N.E.2d 891, 892.

[52]*Id.* at 656, 373 N.E.2d at 892 (emphasis added).

[53]*See, e.g.*, 15 PA. CONS. STAT. ANN. § 7319 (Purdon Supp. 1984); VT. STAT. ANN. tit. 11, § 2402 (1984).

others.[54] Because of this, it is doubtful that the Indiana Act enforces a consistently high level of accountability for managers of all the nonprofits organized thereunder.

2. Accountability at the Operating Stage.—While accountability at the formative stage of a nonprofit is important, accountability at the operating stage is crucial. To satisfy this need, the Indiana Act requires periodic reports relating to the corporation's financial and managerial affairs be filed with the secretary of state.[55] Additionally, the Act requires that corporations maintain accurate books and records, and keep them available for inspection by statutorily-authorized persons.[56]

a. Periodic reports.—Under the Indiana Not-For-Profit Corporation Act, the mandatory annual report is the primary device for disclosure of the corporation's activities.[57] The information disclosed in the annual report includes:

> (a) The name of the corporation.
>
> (b) The location and post office address of its principal office in this state and the name and address of the resident agent or of some designated person residing in this state upon whom service of process may be served.
>
> (c) The date of incorporation.
>
> (d) The law under which it was incorporated.
>
> (e) The names and residence addresses of officers and directors and the number of existing members.
>
> (f) The purposes of the corporation.
>
> (g) A totalled itemized account of all outstanding debts, including the names of persons or corporations to whom sums are owing, the original amount of the debt incurred, the method of making payment, and from what funds the debt is to be paid. If any member, any relative of a member, or any person having a contract or agreement concerning the subject matter of the debt has any interest or opportunity to profit from the transaction, an explanation must be filed together with copies of any written agreements connected with the subject matter of the indebtedness.
>
> (h) A list of all property, real and personal, owned by the corporation, itemized to the extent required by the secretary of state, and its current market value set opposite each respective item, provided that the list of all real property also includes the price paid for it by the corporation, a legal description, the

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[54]*See, e.g., infra* text accompanying notes 148-49.

[55]*See infra* notes 57-62 and accompanying text.

[56]*See infra* notes 63-66 and accompanying text.

[57]IND. CODE § 23-7-1.1-36 (1982).

acreage or size of each tract or lot, and the assessed value of each tract or lot.

(i) The nature and kind of activities in which the corporation has been engaged during the year covered by the report.

(j) What, if any, distribution of funds has been made to any members during the year covered by the report.

(k) A statement of the aggregate amount of any loans, advances, overdrafts or withdrawals and repayments made to or by any officers, directors or members.

(l) A verified itemized statement of revenue received by the corporation from all sources during the preceding calendar year, clearly stating the source of the revenue in each instance, together with a general statement showing total disbursements and all cash and assets. No trust fund shall be included as an asset of the corporation, but must be separately listed and identified.[58]

Because of the importance of the annual report, the statute confers broad reviewing powers upon the secretary of state:

> If, upon receipt of such report, the secretary of state, after reviewing it, determines or has reason to believe that the corporation filing the report is not disclosing its true financial condition or is violating any of the provisions of this chapter or the not-for-profit corporation law in general, he may require the corporation to disclose all material facts by submitting a duly verified audit bearing the certificate under oath of a qualified public accountant recognized by the secretary of state, replying to interrogatories and/or reporting under oath on any matters requested by the secretary of state.[59]

Several features of the Act's annual report requirements are significant. The first and most striking is that the Act does not require a detailed account of corporate distributions. It requires a statement of "[t]he nature and kind of activities in which the corporation has been engaged during the year"[60] and "[a] verified itemized statement of revenue . . . together with a *general* statement showing total disbursements."[61] Thus, nonprofit corporations in Indiana are not required to account to any of their various constituencies for specific corporate disbursements. A literal reading of the Act would permit, for example, a charitable nonprofit to report that it had disbursed $100,000 to two beneficiaries in fulfillment of its charitable purposes. The corporation would not be

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[58] *Id.*

[59] *Id.*

[60] *Id.*

[61] *Id.* (emphasis added).

required by the Act to disclose that it made a grant of $5,000 to one beneficiary and $95,000 to the second. The pattern of distribution and the identity of beneficiaries could be important to past and future donors. Yet, the Act does not mandate the corporation to disclose this type of information.

Second, while most of the emphasis of Indiana Code section 23-7-1.1-36 is on quantitative information, it also requires a statement of "[t]he nature and kind of activities in which the corporation has been engaged during the year covered by the report."[62] Nevertheless, the Act does not require management to send copies of the annual report to members of the corporation or to others.

b. Corporate books and records.—The next structural accountability mechanism at the state level is the statutory requirement that all nonprofits maintain accurate books and records and permit representatives of the state and members of the corporation, under proper circumstances, to inspect them. The Indiana Not-For-Profit Corporation Act provides that "[a]ll books and records of any nature whatsoever . . . shall be open for inspection by any member, for proper purposes at any reasonable time."[63] Thus, on its face, the statute *limits* access to those falling within the statutory definition of "member,"[64] and having a proper purpose. The term "proper purpose" is not defined in the statute or in any judicial opinions. The term has been defined, however, in the context of a for-profit corporation shareholder's right of inspection. A "proper purpose" is one which is germane to an individual's interest in his

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[62]*Id.* Only 14 jurisdictions that have separate nonprofit corporations statutes have a similar provision. ALASKA STAT. § 10.20.625 (1983); ARIZ. REV. STAT. ANN. § 10-1081 (1983); COLO. REV. STAT. § 7-28-101 (1973 & Supp. 1982); GA. CODE ANN. § 22-3301 (1981); IDAHO CODE § 30-1-125 (1980 & Supp. 1983); ILL. ANN. STAT. ch. 32 § 163a 62 (Smith-Hurd 1983); IOWA CODE ANN. § 496.1 (West 1949 & Supp. 1983-84); MONT. CODE ANN. § 35-1-1101 (1983); NEB. REV. STAT. § 21-1981 (1943 & Supp. 1983); N.M. STAT. ANN. § 53-8-82 (1978 & Supp. 1983); OR. REV. STAT. § 61.805 (1981); S.D. CODIFIED LAWS ANN. § 47-24-6 (1983); TEX. REV. CIV. STAT. ANN. art. 1396-9-.01 (Vernon 1979) W. VA. CODE § 31-1-55a (1982).

[63]IND. CODE § 23-7-1.1-13 (1982).

[64]"Member" is defined by statute as:

> one who has signified his intention of being a member of a corporation organized or reorganized under this chapter and who has met the requirements of the corporation for membership, and who has been accepted as a member by the corporation. The term includes trustees or directors or incorporators of a corporation organized or reorganized under this chapter, and for purposes of this chapter the corporation may organize or reorganize although it has no membership apart from its trustees, directors, and incorporators. If in any case membership in the corporation is coextensive with the trustees, directors or incorporators of the corporation, for the purposes of this chapter the trustees, directors, or incorporators shall also constitute members within the meaning of this chapter.

IND. CODE § 23-7-1.1-(2)(g) (Supp. 1985).

capacity as a shareholder.[65] In the case of the nonprofit member, one could argue that a similar standard should be applicable and should allow inspection for the purpose of assessing the performance of management.

In addition to a member's right of inspection, it is clear that the secretary of state is also empowered, under certain circumstances, to require the corporation to permit inspection of its books and records.[66] The Act empowers the secretary of state to require a nonprofit to submit to an audit upon the secretary's determination that the corporation failed to disclose its true financial condition in its annual report.[67]

c. Standards of conduct of officers and directors.—i. Transactions between the nonprofit and its officers and directors.—Under Indiana law, transactions are possible in which a director or officer of a nonprofit corporation has a financial interest, either directly or indirectly, with another entity that is a party to the transaction with the nonprofit. The fact of the relationship or interest must, however, be disclosed to the nonprofit's board of directors or to its members entitled to vote.[68] Yet, no disclosure need be made if the transaction is "fair and reasonable to the corporation."[69]

Two observations are relevant. First, the information required to be disclosed is minimal. Only the "fact of the relationship or interest" need be disclosed.[70] With no Indiana case law on point and no relevant legislative history, the literal language of the statute seems to suggest that the interested director can choose to disclose *either* her relationship with the party contracting with the nonprofit *or* the nature of her interest in the transaction. If the director chooses to disclose the relationship rather than the interest, it may be difficult to determine whether or not she stands to make an unusually large gain from the transaction.[71] Second, assuming fairness of the transaction to the nonprofit, members cannot adequately assess the motivations and general performance of the in-

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[65]*See Charles Hegewald Co. v. State,* 196 Ind. 600, 149 N.E. 170 (1925).

[66]IND. CODE § 23-7-1.1-36 (1982).

[67]*Id.*

[68]*Id.* § 23-7-1.1-61. Note that the statute does not, on its face, apply to transactions with interested officers. *Id.*

[69]*Id.* § 23-7-1.1-61(c).

[70]*Id.* § 23-7-1.1-61(a), (b).

[71]The question of directors' loyalty to the nonprofit is not necessarily the same as the question of whether a transaction is fair and reasonable to the corporation. Even where the transaction is fair, an interested director may be able to make substantial profits through commercial dealings with the nonprofit to the exclusion of other potential competitors. Under these circumstances two serious issues arise: First, is the director dealing with the nonprofit with a view to the corporation's best interest? Second, is the interested director using her position in the nonprofit to advance her own private pecuniary interests?

terested director based upon the information provided in the corporate books and records. Other jurisdictions provide more rigorous conflict of interest provisions.[72]

ii. General standard of care and loyalty.—The Indiana Act does not contain provisions defining general standards of care and loyalty for directors and officers of nonprofit corporations. This is significant because of the express exemption of charitable, educational, and cultural organizations from the standards of conduct imposed on trustees by the Indiana Trust Code.[73] Moreover, the Indiana General Corporation Act, which regulates for-profit corporations, provides that "[a] director shall perform his duties . . . in good faith, in a manner he reasonably believes to be in the best interests of the corporation, and with such care as an ordinarily prudent person in a like position would use under similar circumstances."[74] One might infer that the absence of a statutory provision regarding nonprofit directors may be some indication of a legislative intent to hold nonprofit directors to a lower standard of conduct than for-profit directors.

Some language in the Act indicates, however, that there is a minimal acceptable standard of conduct for directors of nonprofit corporations. Indiana Code section 23-7-1.1-4(b)(9) authorizes a nonprofit to indemnify any director "against expenses actually and reasonably incurred by him in connection with the defense of any civil action" to which he is made a party by reason of his status as a director.[75] Indemnification is not available "in relation to matters as to which he is adjudged . . . to be liable for *negligence* or misconduct in the performance of *duty to the* corporation."[76] Since these provisions speak either in terms of knowing and willful violations or liability for the failure to perform some act, regardless of negligence, they suggest that liability may attach for negligent conduct and that the source of standards against which to measure such conduct is the common law.[77] Thus, the issue of general standards

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[72]*See infra* note 187 and accompanying text.

[73]IND. CODE § 30-4-1-1(c) (1982) provides that the rules of law contained in the Indiana Trust Code do not apply to religious, educational, and cultural institutions or to charitable nonprofit foundations, corporations, or associations, except that these organizations are required to comply with those provisions of the trust code which specifically relate to the maintenance of federal income tax privileges. *See, e.g.*, IND. CODE §§ 30-4-5-18 to -24 (1982).

[74]IND. CODE § 23-1-2-11(a)(2) (Supp. 1985).

[75]IND. CODE § 23-7-1.1-4(b)(9) (1982).

[76]*Id.* (emphasis added).

[77]*Id.* § 23-7-1.1-36 (annual report requirement). Although not directly applicable to the issue of directors' standards of conduct, this section provides some support for the proposition that common law doctrines existing apart from the nonprofit statute also serve to regulate nonprofit conduct. This section specifically provides that the secretary of state may order a nonprofit to submit to a verified audit after reviewing the nonprofit's annual report if he "determines . . . that the corporation filing the report

of care and loyalty would appear to be open for definition by the courts as the common law of nonprofit corporations develops in Indiana.

iii. Provisions for director liability.—The express prohibitions on director conduct in the Indiana Act are aimed primarily at activities which might financially injure corporate creditors, nonprofit members, and the general public. These prohibitions are written so that no personal liability will be imposed on a director unless she was a knowing and willing participant in the proscribed conduct.[78]

Indiana Code section 23-7-1.1-62 describes the basic prohibitions on director conduct relating to corporate debts and contracts, and prescribes the penalties to which directors are subject when the prohibitions are violated:

> The directors of a not-for-profit corporation shall jointly and severally be liable for the debts and contracts of the not-for-profit corporation in the following cases:
>
> (1) For *knowingly and wilfully* declaring or assenting to the repayment of any advance or loan made by a member . . . if the . . . corporation is, or is thereby rendered insolvent . . . in an amount equal to the repayment . . . .
>
> (2) For *knowingly and wilfully* making or assenting to make a loan to an officer or director, to the extent of the debts contracted between the time of making or assenting to make the loan and the time of repaying it, in an amount equal to the loan.
>
> (3) For voting or assenting to any distribution of corporate assets to its members or otherwise during . . . liquidation . . . without payment and discharge of or making adequate provision for, all *known* debts, obligations and liabilities . . . . for the value of those assets which are distributed, to the extent that the . . . [corporate] liabilities . . . are not paid and discharged thereafter.
>
> (4) For voting or assenting to the distribution of [corporate] assets . . . contrary to the provisions of this chapter or . . . any restrictions contained in the articles of incorporation; for the . . . value [of assets distributed].
>
> (5) For voting or assenting to make a loan to an officer or director of the corporation; for the amount of the loan until its repayment.
>
> * * *
>
> A director shall not be liable under subparagraphs (1), (3)

. . . is violating any provision of this chapter [23-7-1.1-1 to -66] or the *not-for-profit corporation law in general.*" *Id.* (emphasis added).

[78] *See* IND. CODE §§ 23-7-1.1-62, -64 (1982).

> or (4) . . . if he *relied and acted in good faith* on financial statements of the corporation, represented to him to be correct by the president or the officer . . . having charge of its account books. . . . Nor shall he be liable if, in good faith in determining the amount available for any distribution, he considered the assets to be at their book value.[79]

This section is designed to prevent directors from making improper distributions to members, directors, or officers that may have the effect of injuring the corporation's creditors. While creditors are given some measure of protection against improper self-dealing within the corporation, this protection is less than complete. Under this provision, directors are relieved from liability for assenting to improper distributions made in good faith reliance upon the presentation of those on whom the directors are entitled to rely.[80] No duty of inquiry into the accuracy of such representations is required.

A second, and possibly more serious, defect in Indiana Code section 23-7-1.1-62 is that many types of misconduct by directors which might result in a substantial depletion of the corporation's assets do not result in director liability. For example, a director would not be liable under this section for corporate debts, even though he had assented to highly speculative investments which resulted in substantial depletion of corporate assets. The Indiana Not-for-Profit Corporations Act does, however, prohibit director conduct which might generally be characterized as fraud on members and the public.[81]

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[79] *Id.* § 23-7-1.1-62 (emphasis added).

[80] *Id.*

[81] The Act provides:

* * *

> (b) An officer or director of a not-for-profit corporation who:
>
> (1) *knowingly* gives out or publishes, or files with the secretary of state, any written report, certificate, or statement of the condition or business of the not-for-profit corporation that is false in any material particular, statement or representation; or
>
> (2) *knowingly* issues, or consents to the acceptance of, any advances or loans to members in violation of this chapter; or
>
> (3) *knowingly* signs or issues a certificate for advances or loans by members containing any false statement;
>
> commits a Class D felony.
>
> (c) An officer or director of a not-for-profit corporation who, being charged with the duty of doing so, fails to make, file, produce, and keep open, prior to and during an election of directors, a list of members of the not-for-profit corporation entitled to vote at the election, commits a Class B infraction.
>
> (d) All officers or directors of a not-for-profit corporation who violate subsection (b) or (c) of this section are jointly and severally liable for all damages which may arise therefrom.

Id. § 23-7-1.1-64 (emphasis added).

Indiana Code section 23-7-1.1-64 serves three separate accountability functions. First, it strengthens the "accountability through disclosure" mechanisms provided by the statutory reporting requirements by subjecting directors to criminal and civil liability for false statements in those reports.[82] Second, it helps to assure that the nonprofit form will not be used for the improper purpose of private pecuniary benefit; directors are personally liable for knowingly issuing or consenting to advances or loans to members in violation of the provisions of the Act.[83] A third function served by this section, and perhaps the most important in accountability terms, is that it imposes liability upon directors who fail to maintain and provide members with membership lists prior to the election of directors.[84] Thus, the Act ensures that members will not be denied the opportunity to change the corporation's management through communication with other members.

iv. Legal consequences to the nonprofit corporation for defective director performance.—The standards and the legal liabilities of directors of nonprofit corporations form an integral part of the accountability mechanisms for nonprofits, serving to assure proper director conduct and, therefore, proper functioning of the nonprofit. In addition to statutory provisions dealing with misconduct of directors, the Indiana Act imposes significant sanctions at the corporate level for defective director performance. Under such circumstances, the nonprofit corporation is treated as if it were synonymous with its defectively performing directors. The statutory scheme compensates, to some extent, for the lack of protection against the misconduct of directors by subjecting the nonprofit to various remedial sanctions:

> If, at any time, the secretary of state is of the opinion that the corporation is not operating in good faith as a not-for-profit corporation, is violating any of the provisions of this chapter, is insolvent or has paid more than the fair and reasonable value for any real or personal property acquired, has engaged in any transaction with any person, firm or corporation which could result in more than a fair and reasonable profit to this person, firm or corporation, has failed to account fully for all proceeds and revenue derived from conducting the activities of the corporation, or has violated any of the laws of this state governing activities of the corporation, or has violated any of the laws of this state governing activities in which the corporation may be

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[82] *Id.* It is not altogether clear what type of civil damages might result from false statements contained in official filings by the nonprofit with the state. IND. CODE § 23-7-1.1-62 appears only to contemplate damages for injury to some property interests.

[83] IND. CODE § 23-7-1.1-64(b).

[84] *Id.* § 23-7-1.1-64(c).

> engaged, he shall withhold the filing of its papers and shall notify in writing the persons or corporation of such violation whereupon the same person or persons may correct any such violation or appeal this decision by the secretary of state.
>
> * * *
>
> If the secretary of state at any time feels that any corporation organized or reorganized under this chapter is *violating any provisions of the chapter*, he shall notify the corporation, in writing, of this violation, and if the corporation does not comply with the provisions within fifteen (15) days thereafter, the secretary of state shall certify this information to the attorney general of Indiana, who shall immediately bring an action in the name of the State of Indiana in the Marion County superior or circuit court to dissolve the corporation.[85]

In this provision, the statute describes those circumstances in which the nonprofit corporation will be subject to legal sanctions for the misconduct of its directors. Many of those circumstances do not give rise to director liability under the director liability provisions. Directors are not expressly liable for assenting to transactions in which persons outside the nonprofit organization receive more than fair or reasonable profits. It is also likely that directors would not be personally liable for the failure to account fully for all corporate revenues or proceeds in the nonprofit's annual report.[86] Finally, directors do not appear to be liable for many other acts that might result in the corporation losing its nonprofit status, such as the failure to do those things required under the provisions of the Indiana Trust Code relating to the maintenance of federal tax exemptions.[87]

Indiana Code section 23-7-1.1-63 serves primarily as a "stop gap" through which director misconduct, not remedied through the imposition of legal sanctions upon directors, may be corrected at the corporate level. The remedial measure provided for by this section is the withholding of the filing of corporate papers by the secretary of state until the nonprofit complies by correcting any violations found by the secretary. If this fails, involuntary dissolution proceedings could be instituted by the state attorney general.[88]

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[85] *Id.* § 23-7-1.1-63 (emphasis added).

[86] IND. CODE § 23-7-1.1-64(b)(1) (1982) imposes liability only for statements which are false in any material particular.

[87] *See supra* note 73.

[88] IND. CODE § 23-7-1.1-66 (1982) provides in part:

> A not-for-profit corporation may be involuntarily dissolved by judgment of the circuit court or any superior court of the county in which the principal office of the corporation is, or was last, located in accordance with the following provisions:

Particularly significant is a provision that allows for court intervention in lieu of dissolution.[89] In that provision, the legislature has recognized that a nonprofit corporation may be composed of individuals and interests reaching beyond those represented by its defectively performing directors. To the extent that the nonprofit has assets which are to be used for the public interest or the interest of those not involved in the conduct resulting in dissolution proceedings, the courts are given broad discretion to fashion an appropriate remedy, other than dissolution, to protect such interests. In this manner, the Indiana Act is designed to protect the nonprofit's beneficiaries.

(a) Causes of Dissolution. Such dissolution may be adjudicated when it is made to appear to such court that:
(1) The period for which the not-for-profit corporation was organized has terminated; or
(2) The corporate franchise was procured through fraud practiced upon the state; or
(3) The not-for-profit corporation has exceeded or abused authority conferred upon it by law or has exercised authority not conferred upon it by law; or
(4) The not-for-profit corporation has failed to file the annual report required by this chapter; or
(5) The not-for-profit corporation has done or failed to do any act which would result in a surrender or forfeiture of its corporate franchise; or
(6) The members are deadlocked in the management of the corporate affairs and the not-for-profit corporation is suffering, or is about to suffer, irreparable injury from this deadlock.
(b) Procedure. All proceedings for the involuntary dissolution of not-for-profit corporations, except as otherwise provided by this chapter, shall be governed by the laws of this state which pertain to civil procedure.

Proceedings for dissolution based upon any of the causes specified in subparagraphs (1) through (5) inclusive of paragraph (a) of this section shall be filed and prosecuted in the name of the state. These proceedings may be filed and prosecuted by the attorney general when he is requested, in writing, to do so by the secretary of state. Before any proceedings based on causes (1), (3), (4) and (5) commence, the secretary of state shall notify the corporation in writing of the cause and of the violation within fifteen (15) days thereafter, the secretary of state shall certify this information to the attorney general who shall immeditely take action to dissolve the corporation in the name of the state of Indiana.

* * *

(g) With respect to a proceeding to dissolve any corporation under this chapter which has, as a part of its fixed assets, an endowment, other fund, or substantial property, which, under the purposes for which the corporation was organized or otherwise, are to be used in the public interest or in the interest of those not involved in the act or omissions causing the dissolution proceedings, the court, sitting as a court of equity, in lieu of dissolving the corporation, shall have the power to make such order as is necessary to protect the endowment fund or property in the public interest or in the interest of others.

[89]IND. CODE § 23-7-1.1-66(g).

Nevertheless, the fact that the continuation of the nonprofit is subject to the court's discretion could operate to circumvent the rights of the members to determine the corporation's future. This fact may reflect a legislative determination that the members are either unwilling or incapable of determining a proper future course of conduct for the corporation, especially when the membership originally may have been responsible for electing and maintaining defectively performing directors in managerial positions. In this regard, however, it should be remembered that one possible reason for the membership's failure or inability to exercise effective control over the nonprofit corporation's management is the failure of the Act to provide for adequate disclosure mechanisms through which the membership could be made aware of its directors' conduct. Although members have access to the corporate books and records for "proper purposes," no information concerning the affairs of the corporation is required to be actually reported to the members in a complete and concise manner.[90] Even where members are sufficiently motivated to examine corporate books and records, the time required to decipher the information necessary to ascertain whether the management is performing adequately could be substantial. Moreover, certain types of information, such as the identity and relationship of persons engaging in transactions with the corporation, might not be revealed through an examination of the corporation's records.

In summary, Indiana's statutory scheme of accountability for the misconduct of directors of nonprofits operates on two levels. In the case of directors' violations of express prohibitions, the Act's remedial measures focus on the directors through the imposition of personal liability. Where the conduct of directors would not subject them to personal liability, however, the Act operates to impose sanctions on the corporation. These corporate sanctions vary depending primarily upon the nature and extent of the interests of the nonprofit's beneficiaries. Curiously, the interest of the nonprofit's nondirector membership does not appear to be a factor in determining the appropriate remedies for correcting defective corporate performance caused by director misconduct.

While statutes can serve as standards for determining the levels and types of accountability owed by corporate management to its constituencies, those statutes are not self-enforcing. Some other institution must exist to interpret statutory provisions definitively and to resolve conflicts between management and its constituencies. In this society, courts have traditionally performed that function.

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[90]There is no requirement for distribution of annual reports to members under the Indiana Not-For-Profit Corporation Act. IND. CODE §§ 23-7-1.1-1 to -66 (1982 & Supp. 1985).

B. Adjudicative Mechanisms

Adjudication is essential to accountability. Some mechanism should be made available to a nonprofit's constituencies to permit them to enforce judicially the obligations of the nonprofit's managers.[91] Since there are several constituencies of nonprofits, however, an interesting issue is presented: Who has standing to challenge the action or inaction of nonprofit corporation managers?

Clearly, the state has standing to protect the interest of the public and to ensure compliance with the law.[92] The authority for the state attorney general to enforce laws relating to nonprofit corporations is rooted in common law and statute.[93] Because the purpose of all nonprofits is to further the public interest in some respect, it is not surprising that the states have delineated quite specific statutory authority for the attorney general to institute lawsuits against nonprofits.

Under the Indiana Act, the authority for enforcement of the nonprofit laws rests primarily in the Office of the Secretary of State.[94] The secretary has authority to compel a nonprofit to submit to a certified public accountant's audit when the secretary has reason to believe that the corporation has either violated provisions of the nonprofit law or has

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[91]The enforcement function was best summarized by Justice Harlan in *Boddie v. Connecticut:*

> Perhaps no characteristic of an organized and cohesive society is more fundamental than its erection and enforcement of a system of rules defining the various rights and duties of its members, enabling them to govern their affairs and definitively settle their differences in an orderly, predictable manner. . . . It is to courts . . . that we ultimately look for the implementation of a regularized, orderly process of dispute settlement.

401 U.S. 371, 374-75 (1971).

Professor Hansmann, arguing for more liberalized standing for a not-for-profit corporation's patrons, said:

> Unfortunately, there is no reason to believe that the attorney general, or any other agency, will become an adequate instrument of enforcement in most states in the foreseeable future. Efforts at reform in this direction have been underway for forty years, and there is still rather little to show for them.

Hansmann, *Reforming Nonprofit Corporation Law,* 129 U. PA. L. REV. 479, 608 (1981) (footnote omitted).

[92]It is the duty of the secretary of state to report violations of the Indiana Not-For-Profit Corporation Act to the attorney general. The attorney general must then bring an action in the name of the state to dissolve the not-for-profit corporation. IND. CODE § 23-7-1.1-63 (1982).

[93]*See* FREEMONT-SMITH, FOUNDATIONS AND GOVERNMENT, 194, 198 (1965). In most states, the attorney general is designated to enforce the responsibilities of nonprofits and their managers. *See* OFFICE OF THE OHIO ATTORNEY GENERAL, *The Status of State Regulation of Charitable Trusts, Foundations, and Solicitations, Commission on Private Philanthropy and Public Needs, Research Papers* 2705, 2710-25 (1977).

[94]*See* IND. CODE § 23-7-1.1-63 (1982).

failed to disclose its true financial condition.[95] He may also compel the nonprofit corporation to disclose all material facts concerning its operations through interrogatories or by requiring it to report such facts under oath. This method is available when the secretary believes that the corporation is operating contrary to law or for the purpose of determining whether or not it is a bona fide nonprofit corporation.[96] When the secretary discovers violations of the law, he is required to withhold the filing of any corporate papers in order to compel compliance. Alternatively, he may inform the attorney general of such violations.[97] In the latter case, the attorney general is required to initiate an action for involuntary dissolution.[98]

The Indiana Act does not authorize the secretary of state or the attorney general to enforce the rights of members, creditors, or beneficiaries. Other than the right to compel a nonprofit to answer interrogatories, neither the secretary nor the attorney general is given the right to inspect corporate books and records. Finally, only one state official in Indiana, the county prosecuting attorney, has the authority to institute an action against a nonprofit to nullify an ultra vires act.[99]

Thus, the state's regulation of nonprofits appears to be limited primarily to determining whether or not the corporation will be permitted to continue to exist or will be dissolved involuntarily. State officials oversee nonprofit conduct through the enforcement of the criminal laws dealing with specified types of misconduct. Other jurisdictions give more authority to state officials to police the activities of nonprofits. Because the Indiana attorney general's statutory authority is so limited, one would rightly question whether others who have a relationship to nonprofits in Indiana have standing to sue the corporation or its management.

The Indiana Not-For-Profit Corporation Act does not contain any provision for derivative actions by members. Consequently, while members can sue both the corporation and the board of directors to enforce their own rights, members have no way to protect the rights of the corporation through adjudication. Unfortunately, Indiana's statutory omission of a provision for derivative rights is typical.[100] Consequently, members of Indiana nonprofit corporations must rely on either the state attorney general or the directors of the corporation to protect the interests of the corporation. Even though members can protect their own interests through adjudiciation, members are not the only constituents of non-

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[95]*Id.* § 23-7-1.1-36.

[96]*Id.* § 23-7-1.1-63.

[97]*Id.*

[98]*Id.*

[99]*Id.* § 23-7-1.1-65.

[100]Only ten jurisdictions explicitly permit members of nonprofits to sue derivatively: California, Delaware, Florida, Illinois, Michigan, New York, Ohio, Pennsylvania, South Carolina, and Wyoming.

profits. The adjudicative rights of two other constituencies are nonexistent. The Indiana Act does not give standing to actual or potential beneficiaries of a nonprofit to sue the corporation or its managers for mismanagement, waste of corporate assets, or any other recognized corporate causes of action.[101] Although the interest of beneficiaries is recognized in a provision of the Act dealing with involuntary dissolution, it appears that protection of such interests may be had only through actions brought in the name of the state.[102] Similarly, the Act does not confer standing on donors.

Obtaining accountability through adjudication in Indiana is possible. Yet, because of restricted standing rules, the lion's share of the enforcement burden falls on the state attorney general.

C. Accountability and the Tax Laws

Special provisions of the state and federal tax codes relating to nonprofits have been enacted to encourage nonprofit activities.[103] Not only do these provisions exempt nonprofit income from taxation, some also permit donors to qualified nonprofits to deduct their donations from their own income taxes.

Simply exempting the activites of certain organizations from income and other taxes can, however, result in rather substantial abuses of the privilege. Some flagrant examples of such abuse already exist. Donors have created charitable foundations and then used the foundations' funds to finance the expansion of the donors' businesses.[104] Trustees of charitable organizations have used their positions as trustees to cause the organization to use the investment advisor or banking services of the interested trustees' investment or commercial bank.[105] Nonprofits have owned and operated businesses that competed unfairly with other businesses.[106] Nonprofits have been used to secure enough of the equity securities of a donor's business corporation to assure the nonprofit's control of the business corporation.[107] Clearly, all of these situations

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[101]There is apparently no statutory authorization for these types of actions by beneficiaries in any jurisdiction in the country.

[102]IND. CODE § 23-7-1.1-63 (1982).

[103]*See, e.g.*, I.R.C. § 501 (1982); CAL. REV. & TAX CODE § 2701(d) (West 1979); DEL. CODE ANN. tit. 30, § 1902 (1975); ILL. REV. STAT. ch. 120, § 2-205(a) (1974); IND. CODE § 6-2.1-3-20 (1982); MICH. COMP. LAWS ANN. § 206.201 (West 1967 & Supp. 1984-85); MO. ANN. STAT. § 143.441(2)(1) (Vernon 1976); WIS. STAT. ANN. § 71-101 (West Supp. 1983-84).

[104]*See generally* WELLS, CONFLICTS INTEREST: NONPROFIT INSTITUTIONS 59, 64-74 (1977).

[105]*Id.* at 29-41; *see also* Stern v. Lucy Webb Hayes Nat'l Training School, 381 F. Supp. 1003 (D.D.C. 1974).

[106]*See, e.g.*, C.F. Meuller Co. v. Commissioner of Internal Revenue, 190 F.2d 120 (3d Cir. 1951).

[107]*See* WELLS, *supra* note 104, at 61-74.

involve an abuse of the nonprofit privilege. In some instances, they also involve a clear breach of a fiduciary duty. Even more importantly, in many cases where the privilege of nonprofit status is abused, money that should be taxed escapes taxation and yet is not used to further any public purpose.

To remedy the abusive uses of the tax laws by donors and managers of nonprofits, the state and federal governments have enacted elaborate laws.[108] These statutes and the accompanying regulations place limits on the types of activities that qualify for exemption, delineate the types of activities that may subject the nonprofit to penalties and fines, and indicate the types of activities that will bar an organization from becoming tax-exempt or that will result in decertification of an exempt organization. Enforcement of these laws by state and federal revenue agencies necessarily renders nonprofit corporations and their managers more accountable.

1. Federal Tax Law.—Subchapter F of the Internal Revenue Code provides for tax-exempt status for several categories of organizations.[109] The most liberal tax benefits are provided to organizations qualifying under section 501(c)(3).[110] There are three requirements for qualifying under this section:

> (1) the entity must be organized and operated exclusively for one or more of the stated exempt purposes: charitable, scientific, literary or educational, the prevention of cruelty to children or animals, or testing consumer products for public safety;
> (2) the organization's net earnings must not inure, in whole or in part, to the benefit of private shareholders or individuals; and
> (3) the organization must not devote a substantial part of its activities to carrying on propaganda or otherwise attempting to influence legislation, nor may it participate in, or intervene in, any political campaign on behalf of any candidate or public office.[111]

Contributions to section 501(c)(3) nonprofits are deductible from the contributor's income tax, subject to limitations based on a percentage of the contributor's income.[112] Contributions to these organizations may also be deducted from estate and gift taxes.[113]

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[108] *Id.*

[109] *See* I.R.C. §§ 501-528 (1982).

[110] *Id.* § 501(c)(3).

[111] *Id. See also* P. TREUSCH & N. SUGARMAN, TAX EXEMPT CHARITABLE ORGANIZATIONS 49 (1979).

[112] I.R.C. § 170 (1982).

[113] *See* I.R.C. § 2055(a)(3) (1982).

Not only does Congress distinguish section 501(c)(3) organizations from other section 501(c) organizations, it also makes a distinction between organizations within section 501(c)(3)[114] pursuant to the Tax Reform Act of 1969.[115] This Act classified all section 501(c)(3) organizations as either public charities or private foundations. Indeed, every section 501(c)(3) nonprofit is presumed to be a private foundation unless it can show

(1) that it is an educational institution, a hospital, church, medical research organization, development foundation of a state university; or
(2) an organization supported in substantial part by government or by contributions from the public; or
(3) an organization that normally receives more than one third of its support from contributions and gross receipts from the public or from governmental units and normally receives not more than one third of its support from gross investment income; or
(4) an organization that is organized and operated for the benefit of, to perform the function of, or to carry out the purposes of, one or more specified public charities described in (1) or (2) and is operated, supervised, or controlled by, or in connection with, one or more such public charities and is not controlled directly or indirectly by one or more "disqualified persons"; and
(5) an organization which is organized and operated exclusively for testing for public safety.[116]

Because of both documented and perceived abuses of their nonprofit status, Congress subjected private foundations to rather strict regulation.[117] They are prohibited from entering into certain transactions with "disqualified persons,"[118] required to pay out to qualified persons or organizations a certain percentage of their noncharitable assets,[119] prohibited from making risky investments,[120] and prohibited from owning, together with a disqualified person, more than twenty percent of the voting stock of a business enterprise.[121]

All of these provisions of the Tax Reform Act of 1969 were designed to make foundation managers and members more accountable to their

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[114]*See id.* § 503(b).
[115]Tax Reform Act of 1969, Pub. L. No. 91-172, 83 Stat. 487 (1969).
[116]I.R.C. § 509(a) (1982).
[117]*Id.*
[118]I.R.C. § 4946 (1982).
[119]*Id.* § 4942.
[120]*Id.* § 4944.
[121]*Id.* § 4943(c)(2)(A).

various constituencies. The prohibition of certain transactions, such as sales or leases of property between a private foundation and a "disqualified person,"[122] is an attempt to prevent donors who create or make substantial contributions to a private foundation from engaging in acts of self-dealing.[123] The provision that requires a minimum annual distribution is designed to prevent charitable organizations from retaining funds, without sound reasons, for long periods of time.[124] The tax exemption provided to private foundations is given on the assumption that it will benefit the public welfare. When private foundations accumulate large sums of money or securities over long periods of time, there is no discernible benefit to the public. Likewise, the public does not benefit from extremely risky investments made by private foundations. The risk-reward analysis engaged in by private capitalists is simply not appropriate for private foundations.[125] Finally, the restriction on business holdings is obviously designed to prevent a donor who wants to gain and maintain control of a business from using a private foundation to facilitate this goal.[126]

The tax laws are helpful in assuring accountability for all tax exempt organizations, not only private foundations. All nonprofits that have acquired exempt status under section 501(c) of the Internal Revenue Code are required to file informational reports.[127] These reports must set forth the organization's gross income, expenses, disbursements for exempt purposes, accumulations, balance sheets, total contributions and gifts received during the year, names and addresses of all substantial contributors if the reporting entity is a private foundation, names and amounts of compensation paid to foundation managers and highly compensated employees.[128] Certain organizations with annual gross receipts of less than $10,000 and most church and religious organizations are exempt from this requirement.[129]

Finally, the Supreme Court of the United States has given the Internal Revenue Service broad powers to determine whether or not nonprofits are complying with the law and policy of the federal government. Indeed, in a recent ruling, the Court quite clearly acknowledged another mech-

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[122]*Id.* § 4941.

[123]*Id.*

[124]*Id.* § 4942.

[125]*See, e.g.,* I.R.C. § 4944 (1982) (penalizing investments by private foundation in such a manner as to jeopardize the carrying out of its exempt purposes). A jeopardizing investment is one that *might* have the effect of preventing the foundation from pursuing its long and short term goals because of its financial situation. *See generally* P. TREUSCH & N. SUGARMAN, TAX-EXEMPT CHARITABLE ORGANIZATIONS 288-92 (1979).

[126]I.R.C. § 4941(d)(1)(E) (1982).

[127]*Id.* § 6033.

[128]Treas. Reg. § 301.6033-1 (1967).

[129]I.R.C. § 6033(a)(2) (1982).

anism to assure nonprofit accountability. In *Bob Jones University v. United States*, and its companion case, *Goldsboro Christian Schools, Inc. v. United States*,[130] the Supreme Court held that the Internal Revenue Service had lawfully revoked the tax-exempt status of one educational institution (Bob Jones University) and lawfully refused to grant tax-exempt status to another (Goldsboro Christian College) because both had racially discriminatory policies.[131] Bob Jones University denied admission to applicants engaged in an interracial marriage or dating and also prohibited interracial dating.[132] Goldsboro Christian College maintained a racially discriminatory policy based upon its interpretation of the Bible, primarily accepting only Caucasian students.[133] The Court held that to qualify for section 501(c)(3) status, an organization must be "charitable" within the common law meaning of "charity," notwithstanding that section 501(c)(3) delineates five types of activities in addition to charitable which could serve to qualify nonprofits. The Court said:

> Section 501(c)(3) therefore must be analyzed and construed within the framework of the Internal Revenue Code and against the background of the congressional purposes. Such an examination reveals unmistakable evidence that, underlying all relevant parts of the Code, is the intent that entitlement to tax exemption depends on meeting certain common law standards of charity—namely, that an institution seeking tax-exempt status must serve a public purpose and not be contrary to established public policy.[134]

The Court held that "racial discrimination in education violates deeply and widely accepted views of elementary justice."[135]

The dissent in this case argued that while it is clear that Congress could prevent organizations engaged in racial discrimination in education from obtaining section 501(c)(3) status, it did not follow that the Internal Revenue Service also has this power. The dissent stated that nothing in the statutory language or history of section 501(c)(3) permitted this conclusion.[136] Nevertheless, the majority eschewed this rather mechanical reading of the statute and upheld the agency determinations. *Bob Jones University* indicates that the Court will willingly permit the Internal Revenue Service to depart from a narrowly defined tax collection function and exercise some policy decisions, at least to the extent that the policy

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[130]461 U.S. 574 (1983).
[131]*Id.* at 595.
[132]*Id.* at 580-81.
[133]*Id.* at 583.
[134]*Id.* at 586.
[135]*Id.* at 592.
[136]*Id.* at 617 (Rehnquist, J., dissenting).

has been well-defined by Congress. Thus, the I.R.S. has some latitude to perform a critically important accountability function when it certifies and decertifies nonprofits for tax-exemption under the Internal Revenue Code.

2. Indiana Tax Laws.—Indiana also provides incentives to people who want to engage in nonprofit activites. Most of the organizations that are qualified to receive tax exemption under section 501(c)(3) of the Internal Revenue Code are also exempt from paying tax on their gross incomes in Indiana, if they file for exemptions and comply with the annual reporting requirement of the tax code.[137] Moreover, organizations operated for fraternal or social purposes or as business leagues or associations are exempt from gross income tax on amounts received as contributions, tuition fees, initiation fees, membership fees, or earnings on receipts from the sale of tangible property.[138]

An organization exempted from the gross income tax is also exempt from the sales tax if (1) the sale is made to make money to carry on its nonprofit purpose and sales are not made during more than thirty days in a calendar year; or (2) the property sold is designed and intended primarily either for the nonprofit organization's educational, cultural, or religious purposes, or for improvement of the work skills or professional qualifications of members; the property sold is not designed or intended primarily for use in carrying on a private or proprietary business; and, the nonprofit is not operated predominantly for social purposes.[139] Indiana also provides a property tax exemption, primarily to organizations that qualify for Internal Revenue Code section 501(c)(3) and (4) exemptions.[140]

The tax privileges extended to nonprofits are premised on the assumption that they will aid these organizations in achieving their objectives. To assure accountability, the Indiana Tax Code requires all organizations that receive these benefits to file an annual report with the Indiana Department of Revenue.[141]

Thus, a second agency in Indiana has an opportunity to determine whether or not nonprofit corporations are operating in compliance with state law, in this case, tax laws. Obviously, this source of accountability is not as authoritative as that of the secretary of state. Unlike the secretary of state who can initiate revocation of the nonprofit status of a corporation, the Indiana Department of Revenue is only empowered to disallow a claimed tax privilege.[142] Nevertheless, the tax laws do serve

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[137]IND. CODE §§ 6-2.1-3-20, -22 (1982).
[138]*Id.* § 6-2.1-3-21 (Supp. 1985).
[139]*Id.* § 6-2.5-5-26 (1982).
[140]*Id.* §§ 6-1.1-10-16, -18.5, -21, -23, -25 (1982 & Supp. 1985).
[141]*Id.* § 6-2.1-3-20.
[142]*See* 45 I.A.C. 1-1-132 (1984).

a type of accountability function insofar as the department of revenue prevents those organizations that do not comply with the laws from securing the tax advantages which it provides.

IV. Statutory Comparisons

The Indiana Not-For-Profit Corporation Act is similar to the nonprofit statutes in most jurisdictions. Most of the nonprofit statutes in the country are unitary.[143] Most jurisdictions require some type of information in the nonprofit corporation's annual report.[144] The overwhelming majority of jurisdictions do not permit members to sue derivatively on behalf of the corporation.[145]

In addition, most states do not define a standard of care and loyalty for the corporation's officers and directors.[146] In at least two jurisdictions, however, the nonprofit statutes contain many provisions that make it possible for members and perhaps other constituents to enforce some level of accountability from corporate management.[147]

A. Structural Mechanisms

1. Accountability at the Formation Stage.—a. New York.—The New York Not-For-Profit Corporation Law[148] provides for four types of nonprofits:

> Type A - A not-for-profit corporation of this type may be formed for any lawful non-business purpose or purposes in-

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[143]H. Oleck, Nonprofit Corporations, Organizations and Associations § 12 (4th ed. 1980).

[144]*See, e.g.*, Ariz. Rev. Stat. Ann. § 10-719 (1977); Colo. Rev. Stat. § 7-20-105 (Supp. 1984); Ga. Code Ann. § 22-3301 (Supp. 1982); Or. Rev. Stat. § 61.805 (1983); W. Va. Code § 31-1-56a (1982).

[145]Express statutory authority for derivative actions by members exists in only two jurisdictions, California and New York. *See* Cal. Corp. Code § 9142(a)(1) (West Supp. 1985); N.Y. Not-For-Profit Corp. Law § 623 (McKinney 1970 & Supp. 1984-85).

[146]Twelve jurisdictions have provisions in their nonprofit statutes which set out a fiduciary duty of care and loyalty for directors. *See* Cal. Corp. Code §§ 309(a), 9002 (West 1977 & Supp. 1985); Conn. Gen. Stat. Ann. § 33-313 (West 1960 & Supp. 1985); Ga Code Ann. 22-2614 (1977 & Supp. 1982); Fla. Stat. Ann. §§ 607.11C4, 617.002 (West 1977 & Supp. 1985); Hawaii Rev. Stat. §§ 416.19, 416.91.5 (1976 & Supp. 1984); Md. Corps & Ass'ns Code Ann. §§ 2-405.1, 5-201 (1985); Minn. Stat. Ann. § 317.20, subd.6 (West 1969); N.Y. Not-for-Profit Corp. Law § 717 (McKinney Supp. 1984-85); 15 Pa. Cons. Stat. Ann. § 7734 (Purdon Supp. 1985); Ohio Rev. Code Ann. § 1702.30(B) (Page Supp. 1984).

[147]Those jurisdictions are California and New York. *See* Cal. Corp. Code § 9142 (West Supp. 1985); N.Y. Not-for-Profit Corp. Law §§ 623, 722 (McKinney 1970 & Supp. 1984-85).

[148]N.Y. Not-For-Profit Corp. Law §§ 101-1515 (McKinney 1970 & Supp. 1984-85).

cluding, but not limited to, any one or more of the following non-pecuniary purposes: civic, patriotic, political, social, fraternal, athletic, agricultural, horticultural, animal husbandry, and for a professional, commercial, industrial, trade or service association.

Type B - A not-for-profit corporation of this type may be formed for any one or more of the following non-business purposes: charitable, educational, religious, scientific, literary, cultural or for the prevention of cruelty to children or animals.

Type C - A not-for-profit corporation of this type may be formed for any lawful business purpose to achieve a lawful public or quasi-public objective.

Type D - A not-for-profit corporation of this type may be formed under this chapter when such formation is authorized by any business or non-business, or pecuniary or non-pecuniary, purpose or purposes specified by such other law, whether such purpose or purposes are also within types A, B, C above or otherwise.[149]

The New York law requires the following information in a proposed certificate of incorporation: corporate name, corporate purpose, location of corporate office, corporate duration, principal location where corporate activities are to be carried on, post office address for mailing legal notice, and any approvals which might be required as prerequisite to information.[150] Type C nonprofits are also required to state what public or quasi-public objective will be fulfilled by each business purpose.[151] Type B and C nonprofits are required to list the names and addresses of the initial directors.[152] Finally, the certificate must be filed with the department of state for approval.[153]

Governmental review of a proposed certificate may encompass a multi-step process, depending upon the type and specific nature of the particular nonprofit corporation. Certain nonprofits are required to obtain special consents or approvals before filing a certificate of incorporation and getting approval from the department of state. Section 404 of the New York law provides a noninclusive list of required approvals.[154] That provision specifically requires judicial approval of all nonprofits seeking to incorporate as Type B or C corporations and all trade and business associations. The section also requires notice to be sent to the

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[149] *Id.* § 201(b) (McKinney 1970).

[150] *Id.* § 402.

[151] *Id.* § 402(a)(2).

[152] *Id.* § 402(a)(5).

[153] *Id.* § 402(a).

[154] *Id.* § 404. Trade and other business associations are Type A nonprofits. N.Y. NOT-FOR-PROFIT CORP. LAW § 1410 (McKinney 1970 & Supp. 1984-85). Judicial approval is not required for other Type A nonprofits. *See id.* § 404 comment.

state attorney general, for the purpose of allowing the attorney general to show cause for denial of judicial approval.[155]

Significant limitations exist upon the authority of governmental officials to withhold approval, even if they find that the proposed nonprofit's purpose is contrary to public policy or that those who will manage the corporation are irresponsible or ill-equipped to carry out their duties. Broadly stated, these determinations are limited to questions of lawfulness and thus appear not to differ from a determination that all formal requirements for incorporation are met.

The case of *In re Queens Lay Advocate Service, Inc.*[156] involved an application for judicial approval for incorporation of a "charitable" nonprofit. The organization, Queens Lay Advocate Service, included among its purposes protecting and expanding the rights of public school pupils, their parents, and the general public, and assisting pupils and their parents in public school disciplinary proceedings. In denying approval, the court noted that the corporate name and stated purpose implied that the nonprofit would provide legal services. Since the provision of legal services by lay persons constituted an unauthorized practice of law, the court found that incorporation for such purposes would violate public policy.[157] The court also noted that those who would operate the corporation were ill-equipped to carry out its purpose, not only because they lacked specialized legal training but also because they lacked legal authorization to give legal advice.[158] *In re Queens Lay Advocate Service* makes clear, therefore, that where a corporation proposes to conduct activities deemed to be unlawful or where those who would operate the nonprofit corporation would be acting unlawfully in carrying out their duties, approval of the certificate of incorporation may be properly denied.

On the basis of *In re Queens Lay Advocate Service*, one might be tempted to generalize that lawfulness is something to be *deduced* from the purposes set out in the articles. The court appeared to read into the stated purposes an implied purpose to engage in the unauthorized practice of law. This generalization, however, may be too hasty, as illustrated by the case of *Owles v. Lomenzo*.[159]

In *Owles*, the secretary of state rejected a proposed certificate of incorporation for the Gay Activist Alliance as contrary to public policy and unlawful. Among the stated purposes of the organization were the following:

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[155]*Id.* § 404(a).

[156]Misc. 2d 33, 335 N.Y.S.2d 583 (1972).

[157]*Id.* at 35, 335 N.Y.S.2d at 585.

[158]*Id.* at 36, 335 N.Y.S.2d at 586.

[159]38 A.D.2d 981, 329 N.Y.S.2d 181 (N.Y. App. Div. 1972), *aff'd sub nom.* 31 N.Y.2d 965, 341 N.Y.S.2d 108 (N.Y. 1973).

> (a) To safeguard the rights guaranteed homosexual individuals by the constitutions and civil rights laws of the United States and the several States, through peaceful petition and assembly and non-violent protest when necessary.
> (b) To speak out on public issues as a homosexual civil rights organization, working within the framework of the laws of the United States and the several States, but vigilant and vigorous in fighting any discrimination based on sexual orientation of the individual.
> (c) To work for the repeal of all laws regulating sexual conduct and practices between consenting adults.
> (d) To work for the passage of laws ensuring equal treatment under the law of all persons regardless of sexual orientation.[160]

Arguably, these purposes imply that the organization would advise its members on legal issues relating to their activities. This possibility was not addressed in the opinion. In granting the petitioner's appeal of the secretary's ruling, the court stated that no public policy of the state would be violated unless the *express* purposes contained in the proposed certificate were unlawful.[161] The court observed that the purposes set forth in the proposed certificate — assembling peacefully to work for change within the law — were not illegal.[162] In requiring the secretary to accept the certificate, the court said, "Were it otherwise it would, in effect, permit the Secretary of State to impose his personal opinion on what he considers improper conduct."[163]

The cases of *In re Queens Lay Advocate Service* and *Owles* demonstrate that determining the lawfulness of proposed purposes is not always clear. The inquiry raises the issue of how far a reviewing governmental official may go in attributing implied unlawful purposes to a proposed nonprofit corporation. This issue, as well as the issue of how far such an official may go to withhold approval where evidence suggests that the persons who will operate the nonprofit are irresponsible, was decided in *Lueken v. Our Lady of the Roses*.[164]

In that case, the petitioner sought judicial approval of a certificate to incorporate a religious nonprofit for the purpose of promoting the

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[160] *Id.* at 982, 329 N.Y.S.2d at 182.

[161] *Id.* at 984, 329 N.Y.S.2d at 183. This definitional rule regarding public policy was first enunciated in Association for the Preservation of Freedom of Choice v. Shapiro, 9 N.Y.2d 376, 214 N.Y.S.2d 388 (1961), and evolved in response to claims of abuse in the withholding of necessary approvals prior to incorporation.

[162] 38 A.2d at 982, 329 N.Y.S.2d at 183. The court did not consider the impact upon the lawfulness of the organization's purposes in light of New York's sodomy laws.

[163] *Id.*

[164] 97 Misc. 2d 201, 410 N.Y.S.2d 793 (1978).

Roman Catholic faith. Opponents of the incorporation claimed that the petitioner was seeking to incorporate in order to circumvent a previously issued court order enjoining her from conducting street services, an order which had been issued after a finding that the services conducted by the petitioner constituted a public nuisance. The court noted that its sole reason for reviewing a proposed certificate was to determine whether or not the purposes stated are in conformity with the law, not to determine the social desirability of the nonprofit.[165] The court stated that it could not presume an unlawful purpose based upon the petitioner's prior conduct and was limited to a consideration of information contained in the certificate about the purposes of the corporation.[166] The court observed that the purposes claimed were not illegal.[167] Thus, it appears that in reviewing a proposed certificate for incorporation under New York law, the review is strictly limited to that information contained in the certificate. Unlawful purposes may not be implied unless the stated purposes contain some clear indication of an intent to carry out unlawful purposes.

b. California.—California's nonprofit corporation law[168] classifies nonprofits by organizational purposes and provides for three types: public benefit nonprofits;[169] mutual benefit nonprofits;[170] and religious nonprofits.[171] The California Nonprofit Corporation Law is similar to the New York law insofar as distinctions are made between various classes of nonprofits. These distinctions determine the nature and volume of information required to be disclosed in connection with the formation and operation of a nonprofit as well as the extent to which a nonprofit will be subject to governmental scrutiny.

The California statute is divided into four primary parts. Part one[172] contains the general provisions and definitions that are applicable to parts two through four. Parts two through four contain provisions relating to the formation, operation, and dissolution of particular classes of

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[165]*Id.* at 202, 410 N.Y.S.2d at 794.

[166]*Id.* at 203, 410 N.Y.S.2d at 795.

[167]*Id.* The court, howver, denied approval because the petitioner failed to obtain approval from the appropriate authorities of the Roman Catholic Church as required under New York's Religious Corporation Law. *Id.* Because petitioner's purposes included promoting the Roman Catholic faith, the proposed corporation was subject to the provisions of both the Religious Corporation Law and the Not-For-Profit Corporation Law. *See* N.Y. RELIG. CORP. LAW § 2 (McKinney 1970 & Supp. 1984-85).

[168]CAL. CORP. CODE §§ 5000-8 (West Supp. 1984).

[169]*Id.* § 5110 (corporations formed for any public or charitable purposes).

[170]*Id.* § 7110 (corporations formed for any lawful purpose that does not contemplate the distribution of gain, profits, or dividends to members except upon dissolution).

[171]*Id.* § 9110 (corporations established primarily or exclusively for religious purposes).

[172]*Id.* §§ 5000-5080.

nonprofits: part two deals with public benefit nonprofits;[173] part three deals with mutual benefit nonprofits;[174] part four deals with religious nonprofits.[175] Generally, public benefit nonprofits are subject to more extensive disclosure requirements and governmental review than mutual benefit nonprofits, which are in turn subject to more extensive regulation than religious corporations. The separate treatment of religious corporations is based upon the constitutional policy of avoiding excessive governmental entanglement into religious affairs.[176]

Under the California Code, less information is required in the proposed articles of incorporation for a nonprofit than is required under either the Indiana or New York statutes. The information required includes corporate name, a statement of purpose, and the name and address of the initial corporate agent.[177] Public benefit nonprofits seeking incorporation for *public* purposes must include, in addition to the specified general statement of purpose, some further description of purpose.[178] In addition, certain other information is specifically authorized to be included within the articles, including information concerning directors, membership, and elaboration upon corporate purposes beyond the minimal statutory statement.[179]

The articles must be submitted to the secretary of state for approval.[180] Section 5008 of the California Code provides that the secretary must give approval and file the article if the content "conforms to law."[181] It appears that the secretary has no discretion to withhold approval based upon a determination that the proposed lawful purposes are contrary to public policy or that those individuals who will control the corporation are unfit for their responsibilities. Moreover, since only a limited amount of information is required to be in the proposed articles, it would seem that such a determination would be virtually impossible

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[173]*Id.* §§ 5110-8910.

[174]*Id.* §§ 7110-8910.

[175]*Id.* §§ 9110-9610. The California law relating to religious nonprofits differs significantly in format from the New York law. Under New York law, the Religious Corporation Law governing religious nonprofits is separate from the Not-For-Profit Corporation Law and is incorporated by reference to the Not-For-Profit Corporations Law. N.Y. RELIG. CORP. LAW § 2-6 (McKinney Supp. 1984-85). When there is a conflict between the Religious Corporations Law and the Not-For-Profit Corporations Law, the Religious Corporations Law governs. *Id.* § 2-b(1)(a). In contrast, the California Law consolidates those provisions relating to religious nonprofits into a single statute. CAL. CORP. CODE §§ 9110-9610 (West Supp. 1984).

[176]*See* Hone, *California's New Nonprofit Corporation Law—An Introduction and Conceptual Background* 13 U.S.F.L. REV. 733, 743 (1979).

[177]CAL. CORP. CODE §§ 5130, 7130, 9130 (West Supp. 1984).

[178]*Id.* § 5130(b).

[179]*Id.* §§ 5132, 7132, 9132.

[180]*Id.* § 5008.

[181]*Id.*

to make. Although there are no California cases dealing with the issue of the secretary of state's discretion to withhold approval of a proposed nonprofit's articles of incorporation, there have been decisions under analogous provisions of the for-profit corporation statute which suggest that the secretary's discretion is limited to determinations of lawfulness of purpose and conformity to formal requirements.[182]

In addition to filing proposed articles with the secretary of state, a copy must be furnished to the secretary to be forwarded to the state attorney general in the case of public benefit corporations.[183] The purpose of this requirement is to facilitate public benefit corporation registration with the attorney general as required under the Uniform Supervision of Trustees for Charitable Purpose Act.[184] This nonprofit corporation law gives the attorney general broad investigatory and enforcement powers over corporate assets held for charitable purposes.[185]

2. Accountability at the Operating Stage.—a. Periodic reports.—The annual report requirements of the Indiana Act are more effective, in accountability terms, than those of New York and California. Neither California nor New York requires nonprofits to state the kinds of activities they have been engaged in for the year. The information required by the annual report provisions in these two jurisdictions is primarily financial.[186] Indiana, as well as fourteen other jurisdictions, requires a statement describing the activities in which the corporation has engaged during the year.[187] The deficiency in the statutes of most of these jurisdictions, however, is that they do not require distribution of annual reports to members. California does require large public benefit nonprofits to send copies of their annual report to members,[188] and smaller

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[182]*See, e.g.,* Rixford v. Vordan, 214 Cal. 547, 6 P.2d 959 (1931) (secretary has no discretion to reject proposed articles of for-profit corporation even though he determines that the proposed corporation will become an unfair competitor in trade).

[183]CAL. CORP. CODE § 5120(d) (West Supp. 1984).

[184]CAL. GOV'T CODE § 12585 (West 1977); *see* Abbott & Kornblum, *The Jurisdiction of the Attorney General Over Corporate Fiduciaries Under the New California Nonprofit Corporation Law,* 13 U.S.F.L. REV. 753, 771 (1979).

[185]*See* CAL. CORP. CODE §§ 5250, 6510, 6511, 6611 (West Supp. 1984).

[186]*See* CAL. CORP. CODE § 6321 (West Supp. 1984); N.Y. NOT-FOR-PROFIT CORP. LAW § 519 (McKinney 1970 & Supp. 1984-85).

[187]*See* ALASKA STAT. § 10.20.625 (1983); ARIZ. REV. STAT. ANN. § 10-1081 (1983); COLO. REV. STAT. § 7-28-101 (1973 & Supp. 1982); GA. CODE ANN. § 22-3301 (1981); IDAHO CODE § 30-1-125 (1980 & Supp. 1983); ILL. REV. STAT. ch. 32, § 163a62 (1983); IND. CODE § 23-7-1.1-36 (1982); IOWA CODE § 496.1 (West 1949 & Supp. 1983-84); MONT. CODE ANN. § 35-1-1101 (1983); NEB. REV. STAT. § 21-1981 (1943 & Supp. 1983); OR. REV. STAT. § 61.805 (1981); S.D. CODIFIED LAWS ANN. § 47-24-6 (1983); TEX. REV. CIV. STAT. ANN. art. 1396-9.01 (Vernon 1979); W. VA. CODE § 31-1-56(a) (1982).

[188]CAL. CORP. CODE § 6321 (West Supp. 1984). For the purpose of requiring nonprofits to send annual reports to members, California distinguishes between public benefit corporations that have more than 100 members or $10,000 in assets during the fiscal year and corporations with fewer members or assets. *Id.*

public benefit nonprofits are required to send copies to members upon request.[189]

b. Standards of Conduct of Officers and Directors.—i. Self-dealing and conflicts of interest.—The New York Not-For-Profit Corporation law provides that directors and officers who have a "substantial financial interest" in transactions with the nonprofit, either directly or indirectly by virtue of a directorship with an entity which is a party to the transaction, must, in good faith, disclose the material facts relating to that interest to the board of directors or members entitled to vote.[190] Absent disclosure, the transaction may be voidable by the nonprofit unless the parties establish that it was fair and reasonable to the corporation at the time of authorization.[191]

The California provisions relating to disclosure of transactions with interested directors also require information concerning the nature of the director's interests.[192] In the case of public benefit and religious nonprofits, where transactions exist between the nonprofit and some other corporation for which a director of the nonprofit also serves as a director, full disclosure as to the nonprofit director's other directorship must be made even though that director might not have a material financial interest in the transaction.[193] Such disclosure is not necessary, however, in the case of public benefit and religious corporations where the state attorney general is notified and approves the transaction.[194] Finally, where disclosure is not made and approval is not given by the attorney general, transactions in which a director of a public benefit or religious nonprofit has a material financial interest are voidable unless it is established that a committee authorized by the board approved the transaction with knowledge of the director's interest, that it was not practical to obtain full board approval prior to the transaction, and that the board subsequently ratified the transaction after making a good faith determination that the first two conditions were met.[195] Thus, the California statute provides incentive to make the required disclosure because voidability turns not on the issue of the fairness of the transaction but on the issue of disclosure.[196]

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[189]*Id.* § 6321(c).

[190]N.Y. NOT-FOR-PROFIT CORP. LAW § 715 (McKinney 1970 & Supp. 1982-83).

[191]*Id.* § 715(b).

[192]CAL. CORP. CODE §§ 5233, 5234, 7233, 9243, 9244 (West 1977 & Supp. 1984).

[193]*Id.* §§ 5234, 9244.

[194]*Id.* §§ 5233(d)(1), 9243(d)(1).

[195]*Id.* §§ 5233(d)(3), 9243(d)(3). These sections do not specifically state that unauthorized self-dealing transactions are voidable. However, they give the court broad discretion to provide a fair and equitable remedy. Presumably, this discretion includes the authority to void unauthorized self-dealing transactions.

[196]Although an unauthorized self-dealing transaction may be voidable due to the failure to disclose, the issue of reasonableness of the transaction to the nonprofit is

ii. General standard of care and loyalty. The Indiana Act does not have a statutory provision that delineates the general standards of care and loyalty required of directors of nonprofit corporations. New York, California, and ten other jurisdictions have such statutory standards.[197] A typical provision is that found in the New York statute:

> (a) Directors and officers shall discharge the duties of their respective positions in good faith and with that degree of diligence, care and skill which ordinarily prudent men would exercise under similar circumstances in like positions.
>
> (b) In discharging their duties, directors and officers, when acting in good faith, may rely upon financial statements of the corporation presented to them to be correct by the president or the officer of the corporation having charge of its books of accounts, or stated in a written report by an independent public or certified public accountant or firm of such accountants fairly to reflect the financial condition of such corporation.[198]

Such a provision is beneficial because it clearly defines the general duty of care for officers and directors. With this kind of provision in a state's nonprofit corporation act, the general duty of care need not await judicial definition.

B. Adjudicative Mechanisms

1. Role of the State Attorney General.—New York, in sharp contrast to Indiana, gives various state officials a great deal of authority to compel compliance with the nonprofit law in general. Most of this authority is vested in the Office of the Attorney General.

Under the New York statute, the attorney general is authorized to maintain actions to dissolve a corporation that has acted ultra vires, (2) restrain a corporation from carrying on unauthorized activities, (3) to dissolve a corporation that was formed improperly, (4) restrain unincorporated associations from exercising corporate rights in the state, (5) remove directors for cause, (6) dissolve the corporation, (7) restrain

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still relevant. Such considerations may be taken into account by the court in determining whether and to what extent interested directors will be liable to the nonprofits for any damages arising out of the transaction. *See id.* §§ 5233(h), 9243(h).

[197]CAL. CORP. CODE § 9241 (West Supp. 1984); N.Y. NOT-FOR-PROFIT CORP. LAW § 717 (McKinney 1970); *see also* CONN. GEN. STAT. ANN. § 33-455 (West 1984); FLA. STAT. ANN. § 617-26 (West 1976) (repealed); GA. CODE ANN. § 14-3-113 (1982); HAWAII REV. STAT. § 416-91.5 (1968 & Supp. 1983); IDAHO CODE § 30-1-35 to -142 (1977); MD. CORPS. & ASS'NS § 2-405.1 (1976 & Supp. 1983); MINN. STAT. ANN. § 317.20 (West 1969); OHIO REV. CODE ANN. § 964 (1984); PA. STAT. ANN. tit. 15, § 2851-506 (Purdon 1959 & Supp. 1983); TENN. CODE ANN. § 48-813 (1979).

[198]N.Y. NOT-FOR-PROFIT CORP. LAW § 717 (McKinney 1970 & Supp. 1984-85).

foreign corporations from acting within the state, (8) enforce members' rights, and (9) compel an accounting upon dissolution. In addition, the attorney general has the right to bring actions against directors and officers for making improper distributions, for an accounting by directors for misconduct, and to enjoin unlawful conveyances.[199]

As with the New York law, California gives the state attorney general expansive power to investigate and bring actions to correct misconduct. The California Code, however, gives the attorney general different amounts of authority depending upon the type of nonprofit corporation involved. For example, the attorney general is given broad powers over public benefit nonprofits. These corporations are subject at all times to examination by the attorney general for the purpose of determining whether or not the corporation has complied with trusts which it has assumed and whether there has been a deviation from the corporate purposes.[200] Moreover, the California attorney general is empowered to bring an action in the name of the state to correct any deviations discovered.[201] He is also empowered to institute suit to remedy any breach of charitable trust by the corporation and to bring an action to recover for the nonprofit any unlawful distribution.[202]

The attorney general is also given the authority to take action with respect to the composition of the board of directors and the protection of certain membership rights, as well as the continuing existence of the nonprofit. He has the authority to institute proceedings to remove directors for breach of the established standards of conduct, abuse of authority or fraudulent conduct, and to intervene in actions challenging the election of directors.[203] Finally, the attorney general is authorized to bring an action for involuntary dissolution based upon certain grounds, including the persistent fraudulent mismanagement or abusive conduct of the nonprofit's management, the existence of serious internal disputes which prevent the corporation from advantageously carrying on its operations, and the failure of a nonprofit to carry out its purpose.[204]

In the case of mutual benefit corporations, the attorney general has relatively limited power, primarily limited to situations where the nonprofit holds assets in charitable trust.[205] This difference in the attorney general's authority in the case of mutual benefit corporations is a reflection of the enforcement role imposed by law on the attorney general to protect the interests of the nonprofit's beneficiaries who would not

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[199] *Id.* § 112.
[200] CAL. CORP. CODE § 5250 (West Supp. 1984).
[201] *Id.*
[202] *Id.* § 7240.
[203] *Id.* § 5250.
[204] *Id.* §§ 6510, 6511.
[205] *Id.* § 7240.

otherwise be in a position to protect themselves. In the context of a mutual benefit corporation where no charitable trust exists, the members are the nonprofit's beneficiaries and, therefore, are in a position to protect themselves. Thus, there is little need for protection action by the attorney general.

Nevertheless, the attorney general is granted authority in certain matters regarding mutual benefit nonprofits, even where no charitable trust is involved. Upon complaint of violations of the nonprofit law by a member, officer, or director, the state attorney general may notify management of the nonprofit of the complaint; the corporation's failure to respond adequately may cause the attorney general to institute proceedings seeking appropriate remedies to protect the rights of members.[206] Thus, the attorney general is empowered to take action where a mutual benefit nonprofit has failed to make required filings with the secretary of state, hold required meetings, or has violated other membership rights.[207]

Finally, the authority of the attorney general over religious corporations is very limited. The attorney general has the power to enforce state criminal laws; bring an action to determine judicially whether or not the organization is properly incorporated as a religious nonprofit; exercise any authority granted regarding required filings with the state, proceedings winding up the corporation, disposition of residual assets after dissolution, payment of liabilities, and criminal penalties; compel the nonprofit to use property solicited and received from the public for the designated purpose, where the nonprofit in making its solicitation represented that such property would be used for specific purposes.[208]

In summary, the role of the state attorney general in enforcing the nonprofit law and protecting the rights of beneficiaries, donors, and creditors varies. The Indiana attorney general's statutory authority appears quite limited compared to the more expansive New York and California statutes.

2. Role of the Members.—The Indiana Not-For-Profit Corporation Act does not contain any provision for derivative actions for members. In contrast, both New York and California nonprofit members have standing to initiate derivative actions. In New York, at least five percent of any class of members must join in the action.[209] In California, however, there is no such requirement. Any members may bring a derivative action if they were members at the time that the complained of transaction

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[206] *Id.* § 8216.

[207] *Id.*

[208] *Id.* § 9230.

[209] N.Y. NOT-FOR-PROFIT CORP. LAW § 623(a) (McKinney 1970 & Supp. 1984-85).

occurred.[210] To mitigate the potential harrassing effects of this liberal standing provision, the statute permits the defendants to request that the court require the plaintiff to furnish security for expenses.[211] The most innovative aspect of the standing provision of the California statute is the extent to which it expressly gives standing to individual members to enforce their membership rights. Members, individually, have standing to bring action for judicial enforcement of the duty of the board to make and deliver any statements or reports required by law, bring action for judicial enforcement of inspection rights, bring action for a court order compelling the nonprofit to call or conduct meetings of members, and bring an action challenging the validity of any election, appointment, or removal of a director.[212]

V. Reforming Indiana's Not-For-Profit Corporation Act

The preceding sections of this Article have analyzed the relevant regulations that exist to monitor and discipline the activities of nonprofits incorporated in Indiana. The major regulatory device, the Indiana Not-for-Profit Corporation Act, compares relatively well with similar statutes in other jurisidictions. Nevertheless, both New York and California have shown that regulation of nonprofit corporations can be much more finely tuned if nonprofits are classified according to their purposes.

Recognizing the different purposes served by different types of nonprofit corporations is not a radical departure for that part of the legal system concerned with regulating organizations that hold and manage resources for identifiable constituencies. Several states have acknowledged, through legislative enactment, the distinction between closely-held and nonclosely-held business corporations.[213] Likewise, most jurisdictions make a legal distinction between general and limited partnerships.[214] Finally, all jurisdictions acknowledge, through regulation, a distinction between charitable and other types of trusts.[215] Perhaps the most significant reason for making these statutory distinctions is that it permits the legislature to define different fiduciary obligations for managers according to the type and function of the organization. Thus, for example,

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[210]Cal. Corp. Code § 5710 (West Supp. 1984).

[211]*Id.*

[212]*Id.* § 5617(a).

[213]*See, e.g.*, Cal. Corp. Code §§ 149, 158 (West 1977); Del. Code Ann. tit. 8, §§ 341-356 (1974).

[214]In a limited partnership, the limited partners are shielded from unlimited liability. To protect this privilege, the limited partner must refrain from taking an active role in the partnership business. *See, e.g.*, Ind. Code §§ 23-4-2-1, -7 (1982). Conversely, a partner in a general partnership has unlimited liability to creditors and has the right to take an active role in conducting the business of the partnership. *See, e.g.*, Ind. Code §§ 23-4-1-6, -15 (1982).

[215]*See generally* G. Bogart, Law of Trusts 200 (1973).

managers of closely-held corporations, where there is virtually no market for the firm's securities, have a much greater fiduciary obligation to minority shareholders in transactions involving the sale or exchange of securities than do managers of large, publicly held corporations.[216]

The danger of statutorily maintaining a single, unitary regulatory standard for organizations that may have a "family resemblance" but serve essentially different purposes is that the statute tends to overregulate as well as underregulate. This kind of statute is currently in force in Indiana. More specifically, the Indiana Act does not have a provision setting out a fiduciary standard for directors of nonprofit corporations. Also, the Act contains no provision for derivative suits by nonprofit members. Additionally, the self-dealing and conflict-of-interest provisions of the Act are not rigorous enough for directors of charitable organizations. Finally, the annual report provision does not require that the report be distributed to members and others. All of these features are shortcomings which emanate from the Act's underregulation of nonprofits. Moreover, one provision of the Act that overregulates is the dissolution provision which requires all assets that cannot be distributed according to the guidelines in the Act to escheat to the state. An analysis of the defects in the Indiana Act is necessary before appropriate remedial measures can be proposed.

A. General Standards of Fiduciary Care and Loyalty

Indiana, like most states, does not have a provision in its nonprofit corporation statute defining the standards of fiduciary care and loyalty owed by directors of these corporations. Consequently, in an action against directors of a nonprofit corporation for a breach of fiduciary duty, the court would be likely to apply the common law standard. Yet, in Indiana, there are no reported cases in which the courts have clearly set out the common law standard. Indeed, there are few cases on the subject in the country. The leading decision is *Stern v. Lucy Webb Hayes National Training School for Deaconesses and Missionaries*.[217] This was the first widely publicized case in which the court explored the potentially applicable fiduciary standards to be applied to directors of nonprofit corporations. The court declined to impose a trustee standard upon the directors as that imposed upon directors of business corporations. The court rationalized the imposition of the corporate standard on the basis of the broader responsibilities of directors of nonprofit corporations who are charged with managing the affairs of an operating corporation, while "the traditional trustee is often charged only with

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[216]*See, e.g.*, Donahue v. Rodd Electrotype Co., 367 Mass. 578, 328 N.E.2d 505 (1975).

[217]381 F. Supp. 1003 (S.D.N.Y. 1974).

the management of the trust funds and can therefore be expected to devote more time and expertise to that task."[218]

The problem with the *Stern* case and with the statutory standard which does exist in a few jurisdictions[219] is that the same standard is applicable to directors of all nonprofit corporations even though their functions vary enormously. For example, the directors of a corporation whose purpose is to assist abused children are held to the same fiduciary standard as the directors of a fraternity. A strong argument can be made that directors of charitable corporations like the one assisting abused children should be held to a higher fiduciary standard than the directors of a mutually beneficial nonprofit corporation like a fraternity.

Charitable nonprofits are fundamentally different from mutual benefit nonprofit corporations. Charitable or public benefit nonprofits[220] are frequently organized to serve a large or indefinite class of beneficiaries, such as alcoholics, abused children, or the poor.[221] Usually, beneficiaries of these corporations do not have an economic interest in the corporation and in some jurisdictions these corporations have no members other than those persons who serve as directors.[222] Moreover, beneficiaries of these corporations rarely sit on the boards of directors or become members of the corporation assisting them. In short, beneficiaries are not in a position to monitor and discipline the corporation's managers.[223] Furthermore, members have insufficient economic incentives to monitor and discipline management.[224]

In contrast, the primary beneficiaries of mutual benefit nonprofits are its members. The only purpose served by most mutual benefits is to further the interests of its members. Thus, the members of these organizations have strong incentives to monitor and discipline management.

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[218]*Id.* at 1013.

[219]*See supra* note 146.

[220]*See* CAL. CORP. CODE § 5111 (West Supp. 1984).

[221]Public benefit nonprofits are distinguished from other nonprofits in roughly the same way that organizations that qualify for tax exemption under I.R.C. § 501(c)(3) (1982) are distinguished from other federally tax exempt organizations.

[222]*See* N.Y. NOT-FOR-PROFIT CORP. LAW § 601 (McKinney 1970 & Supp. 1984-85). In New York, for example, some nonprofit corporations are not required to have members. *See also* MODEL NONPROFIT CORP. ACT § 11 (1973).

[223]As noted, beneficiaries have no standing to sue on behalf of the corporation. *See supra* note 101. Moreover, unless the nonprofit corporation's articles of incorporaion or by-laws specifically provide for it, beneficiaries have no right to attend board or membership meetings or to examine the nonprofit's books and records.

[224]Most members of charitable nonprofit corporations serve in a voluntary capacity, primarily because they believe that the organization is furthering a public purpose of which they approve. Nonprofit statutes in most jurisdictions prohibit these persons from receiving any of the revenues of the nonprofit, except as reimbursement for expenses incurred on behalf of the corporation. Consequently, any legal action taken by these members would be financed totally by them. Even if the action were successful, it would not produce any monetary return to the members.

As previously noted, the Indiana Act does not have a provision specifically delineating the standard of care or loyalty for directors of nonprofit corporations. Additionally, charitable, educational, and cultural organizations are expresly exempted from the standards of conduct imposed on trustees under the Indiana Trust Code.[225] This omission should be cured, and cured in such a way as to impose a higher standard of fiduciary duty on the directors of public benefit nonprofits when compared to mutual benefits. Whether the Indiana courts, in an appropriate case, would impose a higher standard on the directors of charitable nonprofits than on directors of mutual benefit nonprofits is an unanswered question. In view of the absence of statutory language and the absence of classification of nonprofits, the courts could either apply one unitary standard to all nonprofit fiduciaries or recognize the distinction between directors of public and mutual benefit nonprofits.[226] Notwithstanding the exemption of directors of charitable nonprofits from the standards imposed on fiduciaries by the Indiana Trust Code, the courts should impose a higher duty on fiduciaries of public benefits, because of the distinction between public and mutual benefit nonprofits. The tough questions are how one delineates these two standards and how one justifies the distinction.

In answering these questions, the law of business corporations may be helpful. During the first half of this century, some important and innovative changes occurred in the law of business corporations.[227] Nevertheless, business corporation codes in most jurisdictions make no allowance for the distinction between the large publicly-held corporations and small closely-held corporations.[228] These state statutes created more problems for closely-held corporations than for publicly held corporations.[229]

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[225]IND. CODE § 30-4-1-1 (1982).

[226]*See infra* note 233.

[227]One of the most significant of these developments is the judicial and statutory recognition of close corporations. *See* Galler v. Galler, 32 Ill. 2d 16, 203 N.E.2d 577 (1965); Donahue v. Rodd Electrotype Co., 367 Mass. 578, 328 N.E.2d 505 (1975); Clark v. Dodge, 269 N.Y. 410, 199 N.E. 641 (1936); McQuade v. Stoneham, 263 N.Y. 323, 189 N.E. 234 (1934). Examples of other significant developments include Zahn v. Transamerica, 162 F.2d 36 (3d Cir. 1947) (judicial recognition of a fiduciary obligation owed by majority shareholders to minority shareholders when the majority controls the corporation); Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983); Singer v. Magnavox, 380 A.2d 969 (Del. 1977) (judicial recognition of the rights of minority shareholders to be protected against self-dealing by the majority in corporate combinations); DEL. CODE ANN. tit. 8, § 253 (1983) (legislation authorizing a corporation owning 90% or more of the stock of another corporation to merge the subsidiary into the parent without shareholder approval).

[228]*See, e.g.,* IND. CODE §§ 23-1-1-1 to 23-6-3-5 (1982); MISS. CODE ANN. §§ 70-1-1 to 70-9-27 (1972); OKLA. STAT. ANN. §§ 70-1-1 to 70-9-27 (1972); OKLA. STAT. ANN. tit. 18, §§ 1.1-1.25 (West 1953).

[229]*See* Deutsch, *Roses in Search of Gertrude Stein: The Puzzle of the Close Corporation,* 9 U. TOL. L. REV. 458 (1978) (discussing the inherent contradictions of placing the close corporation in a structure designed for the large public corporation).

For example, the owners of closely-held corporations sometimes sought to commit the board of directors to specific courses of action such as the selection of officers and the establishment of their compensation.[230] Shareholders of closely-held corporations also attempted to establish dividend policy through shareholder agreement.[231] Finally, shareholders of closely-held corporations often attempted to increase statutorily-imposed quorum and voting requirements.[232] The combination of judicial opinions and legal articles suggesting that the distinction between closely-held and other corporations be acknowledged through statutory reform was eventually successful.[233] Today, several jurisdictions have provisions in their business corporation statutes that apply only to closely-held corporations.[234] Unfortunately, in spite of these legislative developments, courts did not recognize a distinction between the obligations owed by the fiduciaries of publicly-held corporations as opposed to those owed by the fiduciaries of closely-held corporations.[235]

Finally, in 1975, the Supreme Judicial Court of Massachusetts held that the majority shareholders of closely-held corporations owed a higher duty to a minority shareholder than the majority owed to the minority in nonclosely-held corporations.[236] In *Donahue v. Rodd Electrotype Co.*,[237] Rodd, a former director, officer, and controlling shareholder of a close corporation offered to sell to the corporation his shares of its own stock. Rodd made the offer to his son who was president and general manager of the corporation. Subsequently, the board of directors authorized the company to purchase forty-five shares from Rodd at $800 per share. Approximately one year later, a special shareholders' meeting was held at which the transaction was officially disclosed. Mrs. Donahue, a minority shareholder, voted against a resolution ultimately adopted by the other shareholders ratifying the stock repurchase from Rodd. Mrs. Donahue then offered her shares for sale to the corporation on the same terms as those given to Rodd, but the corporation refused to buy them. She instituted suit, alleging that the stock repurchase by Rodd Electrotype was a violation of fiduciary duties owed to her by the defendants in their respective capacities as controlling

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[230]*See, e.g.*, McQuade v. Stoneham, 263 N.Y. 323, 189 N.E. 234 (1934).

[231]*See, e.g.*, Clark v. Dodge, 269 N.Y. 410, 199 N.E. 641 (1936).

[232]*See, e.g.*, Benintendi v. Kenton Hotel, 294 N.Y. 112, 60 N.E.2d 829 (1945).

[233]*See, e.g.*, Galler v. Galler, 32 Ill. 2d 16, 203 N.E.2d 577 (1964); Hetherington, *Trends in Legislation for Close Corporations: A Comparison of the Wisconsin Business Corporation Law of 1951 and the New York Business Corporation Law of 1961,* 1963 WIS. L. REV. 92.

[234]*See, e.g.*, CAL. CORP. CODE § 158 (West Supp. 1984); DEL. CODE ANN. tit. 8, §§ 341-356 (1983), N.Y. BUS. CORP. CODE §§ 620, 630 (McKinney 1970 & Supp. 1983).

[235]*See* Donahue v. Rodd Electrotype Co., 367 Mass. 578, 328 N.E.2d 505 (1975).

[236]*Id.* at 590-91, 328 N.E.2d at 515-16.

[237]367 Mass. 578, 328 N.E.2d 505 (1975).

shareholders, officers, and directors. She sought to have the purchase rescinded on the basis of its infringment of her personal rights as a minority shareholder. More specifically, she urged that the controlling shareholders had a duty to offer her, as a minority shareholder, an equal opportunity to sell her shares to the corporation.[238] The Rodd family, as defendants, denied that a right to equal opportunity existed in corporate stock purchases for the corporate treasury. The trial court ruled for the defendants, finding that the transaction had been carried out in good faith and with inherent fairness.[239] The case was affirmed by the intermediate appeals court.[240] The Supreme Judicial Court of Massachusetts reversed,[241] noting that shareholders in close corporations face a restricted market for their holdings and that the remedy of voluntary dissolution was available primarily to majority interests. The court held that the dissident minority shareholder was entitled to protection.[242] The court stated that the majority shareholders had breached a fiduciary duty to the plaintiff and must afford her an equal opportunity to sell her shares to the corporation.[243] More importantly, the court imposed a new fiduciary standard upon the majority shareholders:

> Because of the fundamental resemblance of the close corporation to the partnership, the trust and confidence which are essential to this scale and manner of enterprise, and the inherent danger to minority interests in the close corporation, we hold that stockholders in the close corporation owe one another substantially the same fiduciary duty in the operation of the enterprise that partners owe to one another. . . . [W]e have defined the standard of duty owed by partners to one another as the utmost good faith and loyalty. Stockholders in close corporations must discharge their management and stockholder responsibilities in conformity with this strict good faith standard.[244]

Two years later, the Massachusetts Supreme Judicial Court reaffirmed this standard and imposed liability on the majority shareholders of a nursing home incorporated as a close corporation when they engaged in a "freeze-out" of a minority shareholder.[245]

The relevance of this judicially created distinction is that it may help to justify a similar distinction between the obligations of fiduciaries

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[238]*Id.* at 585, 328 N.E.2d at 511.
[239]*Id.* at 582, 328 N.E.2d at 508.
[240]*Id.*
[241]*Id.* at 594, 328 N.E.2d at 521.
[242]*Id.* at 593, 328 N.E.2d at 519.
[243]*Id.* at 594, 328 N.E.2d at 520.
[244]*Id.* at 590, 328 N.E.2d at 515 (footnotes omitted).
[245]Wilkes v. Springside Nursing Home, Inc. 370 Mass. 842, 353 N.E.2d 657 (1976).

of public benefit and mutual benefit nonprofit corporations. The court in *Donahue* relied heavily on the trust and confidence which the law permits partners to have in each other.[246] The relationship is not one that imposes trust standards on partners, but it is clearly one that imposes a fiduciary obligation on them that is higher than the fiduciary obligations of directors of corporations.[247] The trust standard is inappropriate because total reliance on one partner to conduct *all* of the affairs of the partnership for the benefit of the other partner or partners is absent.[248] Each partner serves as a fiduciary for the other partners and, unlike a beneficiary of a trust, each partner has the right to participate in partnership decisionmaking. Nevertheless, partners frequently have committed most of their capital to the partnership under circumstances that make withdrawal from the partnership difficult without suffering severe financial loss. Since the mere status of partnership subjects participants to the law of agency, the partners are forced to have trust and confidence in each other. This is the reason that partnership agreements commonly provide partners with some type of veto power over new partners.

Many businesses that would otherwise operate as partnerships are incorporated to avoid the personal liability of the owners.[249] Nevertheless, the owner-managers of these businesses attempt to organize them so that they have the best of both worlds, so that they are operated as partnerships would be operated but have the corporate advantages of limited liability and perpetual existence. Their solution is the formation of a closely-held corporation. The court in *Donahue* said that a close corporation was "typified by (1) a small number of stockholders; (2) no ready market for the corporate stock; and (3) substantial majority stockholder participation in the management, direction, and operation of the corporation."[250] The critical distinction facing minority shareholders in publicly-held corporations compared to minority shareholders in closely-held corporations is that there is generally a market for the stock held by the former. The minority shareholder in a publicly held corporation is not locked in. The rule of equal opportunity announced in *Donahue* has not been applied to transactions in shares in large, publicly-held corporations precisely because of this "exit option" for minority shareholders.[251] It is suggested that the distinction between fiduciaries of public

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[246]367 Mass. at 590, 328 N.E.2d at 515.

[247]*Id.* at 590-91, 328 N.E.2d at 515-16.

[248]That is, a partner is not a trustee for the other partners. Rather, each partner owes every other partner a fiduciary obligation to conduct the affairs of the partnership for the benefit of *all* partners.

[249]*See Symposium on the Close Corporation,* 52 NW. U.L. REV. 345, 347 (1957).

[250]367 Mass. at 585, 328 N.E.2d at 511.

[251]The existence of the exit option does not, however, imply that the majority shareholders or directors of publicly-held corporations can engage in transactions or cause the corporation to take actions which injure minority shareholders.

and mutual benefit nonprofits should be drawn on the same basis that the court in *Donahue* drew the distinction between fiduciaries of closely-held and publicly-held corporations. The analogy is worth examining more closely.

The relationship between beneficiaries of, and perhaps donors to, public benefit nonprofits and the managers of these corporations resembles the fiduciary relationship between majority and minority shareholders of close corporations. First, decisions of managers of public benefit nonprofits are final and not subject to reversal or ratification because there are generally few members of these corporations. In close corporations, the decisions of the managers are also final because they generally own the majority of the outstanding shares of the corporation. Second, the beneficiaries of many public benefit nonprofits may have few or no effective "exit" options. That is, it is not likely that a poor person who is aided by a charity will decline benefits because he opposes management's decisions or believes that management is breaching a fiduciary duty. Similarly, patients in hospitals cannot easily move from one hospital to another. In sum, the beneficiary of a public benefit nonprofit resembles, in this respect, the minority shareholder of a close corporation who finds "exit" difficult because of the absence of a market for her shares.

Similarly, the shareholders of publicly-held corporations are analogous to members of mutual benefit nonprofits. The striking characteristic of most mutual benefit nonprofits is that they are organized to advance the interests of their members. Of course, this does not mean that mutual benefits do not serve a public purpose also; they do. Labor unions, for example, serve to reduce tension among laborers and management and to improve the workplace conditions of laborers.[252] Nevertheless, in the process of achieving these goals, labor unions also benefit their members.[253] Consequently, most mutual benefit nonprofits, like labor unions, have members who are active. The members of these nonprofits have an incentive to vote for management, to communicate their concerns to management, and, ultimately, to resign or exit from the organization if they become too disaffected. Members of mutual benefits share all of these characteristics with stockholders of publicly-held corporations. For example, there is generally a market for membership in organizations like country clubs, social clubs, and civic organizations.[254] In some jurisdictions, members can sue derivatively and managers of mutual benefit nonprofits are vulnerable to ouster at annual elections.[255]

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[252]*See* Labor Management Relations Act § 1, 29 U.S.C. §§ 141-69 (1982).

[253]*Id.*

[254]*See* Buchanan, *An Economic Theory of Clubs,* 32 ECONOMICA 1 (1965).

[255]In every jurisdiction where there is a separate nonprofit statute, the statute requires an annual meeting for the purpose of electing directors. *See, e.g.,* IND. CODE §§ 23-7-1.1-9, -10 (Supp. 1985).

In summary, it is recommended that a distinction be made between the fiduciary duties of managers of public benefit nonprofits and mutual benefit nonprofits. Directors of public benefit nonprofits should be held to the partnership standard of utmost good faith and loyalty, while it is appropriate to hold the directors of mutual benefit nonprofits to the standard of care and loyalty imposed on directors of public corporations.

B. Self-Dealing and Conflicts of Interest

The self-dealing and conflict of interest provision of the Indiana Not-For-Profit Corporation Act contains the same language as its counterpart in the Indiana Business Corporations Act.[256] It states:

> No contract or other transaction between a corporation and one or more of its directors or any other corporation, firm, association or entity in which one or more of its directors is a director or officer or is financially interested, shall be either void or voidable because of this relationship or interest or because the director or directors are present at the meeting of the board of directors or a committee thereof which authorizes, approves or ratifies such contract or transaction or because his or their votes are counted for such purpose, if:
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> (a) The fact of this relationship or interest is disclosed or known to the board of directors or committee which authorizes, approves, or ratifies the contract or transaction by a vote or consent sufficient for the purpose without counting the votes or consents of such interested directors, or
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> (b) The fact of such relationship or interest is disclosed or known to the members entitled to vote and they authorize, approve or ratify such contract or transaction by vote or written consent; or
>
> (c) The contract or transaction is fair and reasonable to the corporation.
>
> Common or interested directors may be counted in determining the presence of a quorum at a meeting of the board of directors or a committee thereof, which authorizes, approves or ratifies such contract or transaction.[257]

Although this provision may be adequate for business corporations, it is not sufficient to protect beneficiaries of and donors to public benefit nonprofits. To be sure, the Indiana Trust Code subjects certain Indiana

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[256]*Compare* IND. CODE § 23-7-1.1-61 (1982) (conflict of interest in nonprofit setting) *with* IND. CODE § 23-1-10-6 (1982) (conflict of interest in for-profit setting).

[257]*Id.* § 23-7-1.1-61.

nonprofits to a higher standard regarding self-dealing.[258] That standard prohibits private foundations from engaging in certain transactions with disqualified persons.[259] Foundation managers and their substantial contributors are considered disqualified persons.[260] Therefore, a certain number of public benefit nonprofits in Indiana are already subject to a much stricter self-dealing and conflicts of interest provision than that provided by the Not-For-Profit Act. Nevertheless, there are some public benefit nonprofits that are not private foundations and therefore are exempt from the Indiana Trust Code provisions.

Beneficiaries and donors have no easy way to detect managerial self-dealing. They are not permitted to sue on behalf of the corporation and the disclosure provisions of the Act make it extremely unlikely that beneficiaries, members, and donors will be able to determine whether the managers have engaged in some form of self-dealing.

One way of reducing the potential of self-dealing by managers of public benefit nonprofits that are not covered by the Indiana Trust Code is flatly to prohibit any dealings between the managers of these nonprofits and their corporations. This could be accomplished by amending the Indiana Trust Code to include *all* public benefit nonprofits. This may, however, be too stringent.

When it limited the application of the trust code standard, the Indiana legislature probably meant to leave some flexibility for nonprofits that were not private foundations. A sale or exchange of property between a private foundation and a disqualified person, for example, is prohibited by the Tax Reform Act.[261] Yet, under some circumstances it is conceivable that the *best* purchase of land for a public benefit nonprofit is from either a foundation manager or a substantial contributor. It would appear that there are fewer risks of abuse if the Indianapolis YMCA engages in this type of transaction than if a small, family controlled foundation does so. Despite the recognized difference between private foundations and other public benefit nonprofits, the conflict of interest provision of the Indiana Act should be strengthened considerably. An attractive alternative to subjecting all public benefit nonprofits to the Indiana Trust Code self-dealing provisions would be to adopt a provision similar to the California self-dealing law.[262]

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[258]*Id.* § 30-4-5-21.

[259]*See supra* notes 193-94 and accompanying text.

[260]*See* I.R.C. § 4946(a)(1), (2) (1982).

[261]*See id.* § 4941(d).

[262]§ 5233. Self-dealing transactions; interested director; exceptions; actions; burden of proof; limitations; remedies

(a) Except as provided in subdivision (b), for the purpose of this section, a self-dealing transaction means a transaction to which the corporation is a party and in which one or more of its directors has a material financial interest and which does not meet the requirements of paragraph (1), (2), or (3) of sub-

This provision is superior to the current Indiana provision because it places the burden of persuasion on the person accused of self-dealing and it forces the managers of the corporation to show that the transaction authorized was *the* most "advantageous" under the circumstances. As opposed to the generalized fairness standard imposed by the Indiana

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division (d). Such a director is an "interested director" for the purpose of this section.

(b) The provisions of this section do not apply to any of the following:

(1) An action of the board fixing the compensation of a director as a director or officer of the corporation.

(2) A transaction which is part of a public or charitable program of the corporation if it: (i) is approved or authorized by the corporation in good faith and without unjustified favoritism; and (ii) results in a benefit to one or more directors or their families because they are in the class of persons intended to be benefited by the public or charitable program.

(3) A transaction, of which the interested director or directors have no actual knowledge, and which does not exceed the lesser of 1 percent of the gross receipts of the corporation for the preceding fiscal year or one hundred thousand dollars ($100,000).

(c) The Attorney General or, if the Attorney General is joined as an indispensable party, any of the following may bring an action in the superior court of the proper county for the remedies specified in subdivision (h):

(1) The corporation, or a member asserting the right in the name of the corporation pursuant to Section 5710.

(2) A director of the corporation.

(3) An officer of the corporation.

(4) Any person granted relator status by the Attorney General.

(d) In any action brought under subdivision (c) the remedies specified in subdivision (h) shall not be granted if:

(1) The Attorney General, or the court in an action in which the Attorney General in [sic] an indispensable party, has approved the transaction before or after it was consummated; or

(2) The following facts are established:

(A) The corporation entered into the transaction for its own benefit;

(B) The transaction was fair and reasonable as to the corporation at the time the corporation entered into the transaction;

(C) Prior to consummating the transaction or any part thereof the board authorized or approved the transaction in good faith by a vote of a majority of the directors then in office without counting the vote of the interested director or directors, and with knowledge of the material facts concerning the transaction and the director's interest in the transaction. Except as provided in paragraph (3) of this subdivision, action by a committee of the board shall not satisfy this paragraph; and

(D) (i) Prior to authorizing or approving the transaction the board considered and in good faith determined after reasonable investigation under the circumstances that the corporation could not have obtained a more advantageous arrangement with reasonable effort under the circumstances or (ii) the corporation in fact could not have obtained a more advantageous arrangement with reasonable effort under the circumstances; or

(3) The following facts are established:

(A) A committee or person authorized by the board approved the transaction

Act, the California Act forces the directors to show that of all the options considered they chose the one that was most advantageous. This eliminates the possibility of selecting one method of proceeding with a deal and then simply characterizing that deal as fair. The managers must be able to show that they considered several methods and then must demonstrate that the one selected was the most advantageous.

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in a manner consistent with the standards set forth in paragraph (2) of this subdivision;

(B) It was not reasonably practicable to obtain approval of the board prior to entering into the transaction; and

(C) The board, after determining in good faith that the conditions of subparagraphs (A) and (B) of this paragraph were satisfied, ratified the transaction at its next meeting by a vote of the majority of the directors then in office without counting the vote of the interested director or directors.

(e) Except as provided in subdivision (f), an action under subdivision (c) must be filed within two years after written notice setting forth the material facts of the transaction and the director's interest in the transaction is filed with the Attorney General in accordance with such regulations, if any, as the Attorney General may adopt or, if no such notice is filed, within three years after the transaction occurred, except for the Attorney General, who shall have 10 years after the transaction occurred within which to file an action.

(f) In any action for breach of an obligation of the corporation owed to an interested director, where the obligation arises from a self-dealing transaction which has not been approved as provided in subdivision (d), the court may, by way of offset only, make any order authorized by subdivision (h), notwithstanding the expiration of the applicable period specified in subdivision (e).

(g) Interested directors may be counted in determining the presence of a quorum at a meeting of the board which authorizes, approves or ratifies a contract or transaction.

(h) If a self-dealing transaction * * * has taken place, the interested director or directors shall do such things and pay such damages as in the discretion of the court will provide an equitable and fair remedy to the corporation, taking into account any benefit received by the corporation and whether the interested director or directors acted in good faith and with intent to further the best interest of the corporation. Without limiting the generality of the foregoing, the court may order the director to do any or all of the following:

(1) Account for any profits made from such transaction, and pay them to the corporation;

(2) Pay the corporation the value of the use of any of its property used in such transaction; and

(3) Return or replace any property lost to the corporation as a result of such transaction, together with any income or appreciation lost to the corporation by reason of such transaction, or account for any proceeds of sale of such property, and pay the proceeds to the corporation together with interest at the legal rate. The court may award prejudgment interest to the extent allowed in Section 3287 or 3288 of the Civil Code. In addition, the court may, in its discretion, grant exemplary damages for a fraudulent or malicious violation of this section.

CAL. CORP. CODE § 5233 (West Supp. 1984).

The Indiana provision on self-dealing and conflicts of interest is satisfactory for mutual benefit nonprofits if members of these corporations are permitted to sue derivatively to protect the corporation from managerial self-dealing. If the legislature grants this right, then members of mutual benefit nonprofits should be able to protect themselves and the corporation against managerial self-dealing. If, however, members of mutual benefit nonprofits are not granted the right to sue derivatively, the legislature should enact a law similar to the California self-dealing provision, and it should be made applicable to both mutual benefit and public benefit nonprofits.

C. Standing

The Indiana Act makes no provision for derivative actions by members, donors, or beneficiaries of nonprofit corporations. Consequently, the secretary of state and the attorney general must protect nonprofits in Indiana if their managers refuse to do so or if the managers injure the corporations. The attorney general may resort to litigation, if necessary, to protect these corporations. Yet, it is difficult to believe that the attorney general has the resources to monitor adequately the affairs of more than twenty-five thousand corporations. What is needed is a legal mechanism to permit private enforcement of the rights of Indiana nonprofits. That there is need for private enforcement mechanisms is only an assumption. It is unknown whether managerial abuses exist, or how much of it exists in nonprofits incorporated in Indiana. Nor is it known how vigilant managers of Indiana nonprofit corporations are in seeking to enforce the rights of the corporation against third parties. There is no claim that there is widespread managerial abuse of nonprofits or that managers are lax in enforcing corporate claims against third parties. Rather, the more modest proposal is that the Indiana Act be amended to provide for derivative rights. If this proposal is considered, the relevant question becomes: Who should have the right to sue derivatively?

The law of business corporations may be helpful in answering this question. Shareholders of business corporations are permitted by statute in most jurisdictions to protect the corporation's interests by suing derivatively.[263] The theory of such causes of action is that shareholders have an investment in the corporation and are entitled to seek redress for corporate injury when that injury is inflicted by the managers of the corporation or when the managers of the corporation refuse to take action against a third party who has injured the corporation.[264] The

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[263] *See, e.g.*, N.Y. BUS. CORP. LAW § 623 (McKinney 1970).

[264] *See* Stevens v. Lowder, 643 F.2d 1078 (5th Cir. 1981); Taormina v. Taormina Corp., 32 Del. Ch. 18, 78 A.2d 473 (1951); Kavanaugh v. Kavanaugh Knitting Co., 226 N.Y. 185, 123 N.E. 148 (1919).

nature of the shareholder's investment in the business corporation is both economic, insofar as he has made capital available to the corporation and expects a return on this capital, and political, insofar as he holds voting stock and expects to participate in the selection of management and in fundamental decisions about the corporation's future. The legislature should consider whether one can justify derivative actions in the nonprofit context on this rationale.

Using this analogy, one could argue that members of nonprofits who have an investment in the nonprofit that resembles the shareholder's investment in the business corporation should be permitted to sue derivatively. To be sure, there are members of nonprofits who have an investment in the nonprofit that resembles the shareholder's investment in the business corporation. Members of social clubs, labor and agricultural organizations, and fraternal associations are examples.[265] In all of these, the nonprofit's members have both an economic and a political investment. Nevertheless, a rule of law limited to such a narrow segment of the broad category of nonprofit organizations is less than optimal. What is needed is a theoretical basis for broadening the scope of the rule.

If attention is shifted from the individual shareholder's or member's investment in the enterprise to society's investment in nonprofits, the justification for permitting derivative actions by members of both public and mutual benefit nonprofits becomes more compelling. Defining society's stake in nonprofits is not a difficult task. The availability of the corporate form, with its substantial advantages and various forms of tax exemptions, gives society a sufficient basis for insisting upon as much accountability as possible without, of course, unnecessarily restricting the ability of nonprofits to produce the results most desired. Moreover, donors, beneficiaries, and members have, at the very least, an interest in regulation that provides appropriate accountability mechanisms.

At a bare minimum, it would seem that the Indiana Act should be amended to permit derivative actions by members of nonprofits. Several jurisdictions have already included a derivative action provision in their nonprofit statutes.[266] Additionally, the notion of permitting private parties

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[265]The members in these organizations are the *primary* beneficiaries. In most cases, they pay membership fees or dues which are used by the organization to further the interests of the members. The return on the "investment" of the members comes in the form of laws or regulations which help the members conduct their private businesses more profitably, broader social contacts, and a heightened sense of group identification for members of fraternal organizations.

[266]Nine state nonprofit statutes permit members of the corporation to sue derivatively. The states are California, Delaware, Florida, Idaho, New York, Oklahoma, Pennsylvania, South Carolina, and Wyoming. *See, e.g.*, DEL. CODE ANN. tit. 8, § 327 (1983); IDAHO CODE § 30-1-49 (1980); N.Y. NOT-FOR-PROFIT CORP. LAW § 623 (McKinney 1970 & Supp. 1984-85).

to enforce corporate governance statutes, even in the absence of specific statutory lanaguage providing for private actions, is now generally accepted by the courts. The courts have treated these parties as "private attorneys general."[267]

Whether private attorneys general are needed in the case of nonprofits is an empirical question, one that cannot be answered in this Article. Nevertheless, the existence of a mechanism to activate member interest in vindicating the corporation's rights may be one way to answer that empirical question. If there are many such suits, one may conclude that such a mechanism was indeed needed. If there are no suits, the availability of such a mechanism has certainly caused no harm.

Several questions must be answered before the proposed amendment can be justified. First, while members of some mutual benefit nonprofits may have an economic incentive to sue derivatively, what incentive would members of public benefit nonprofits have to sue derivately? Second, assuming that members of all nonprofits would have an incentive to utilize the derivative action provision, what benefits would accrue to the constituencies of nonprofits if such a provision were adopted? Finally, what safeguards need to be established to guard against the possibility of nuisance and strike suits?

There is no easy answer to the first question. Members of public benefit nonprofits generally serve in such a capacity *primarily* to help the corporation attain the desired goal. They rarely have a personal economic interest or stake in the organization. Realistically, it is highly improbable that members of public benefit nonprofits will sue either their managers or third parties derivatively. Beyond the fact that they are "public-spirited," why people serve as members of public benefit nonprofits is an unknown.[268] These public-spirited members, who appear at the annual meetings of nonprofits, spend their time engaged in voluntary work for the organization, and make periodic contributions to the organization, may well institute derivative actions if the circumstances are particularly egregious.[269] Certainly, suits instituted by members of public benefit nonprofits could benefit their constituencies.

The benefit to be derived by the successful prosecution of a derivative suit lies primarily in the fact that it will establish another level of accountability for the corporation's managers. Perhaps the very existence of a mechanism permitting member derivative actions may cause the

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[267]*See, e.g.,* Mills v. Electric Auto-Lite Co., 396 U.S. 375, 396 (1970); Newman v. Piggie Park Enterprises, Inc., 390 U.S. 400, 402 (1968); Associated Industries v. Ickes, 134 F.2d 694, 704 (2d Cir. 1943), *vacated as moot,* 320 U.S. 707 (1943).

[268]*See* PHELPS, INTRODUCTION in ALTRUISM, MORALITY AND ECONOMIC THEORY (1975).

[269]*See, e.g.,* Stern v. Lucy Webb Hayes Nat'l Training School, 381 F. Supp. 1003 (D.D.C. 1974).

directors to become more circumspect in their dealings with the nonprofit. Clearly, the absence of managerial self-dealing and conflicts of interest benefits the constituencies of these organizations. Of course, the effectiveness of the proposed derivative action provision is causally related to the extensiveness of the disclosure provisions. If members do not have access to sufficient information about the nonprofit's operations, it will be difficult for them to detect managerial indiscretions. Assuming adequate disclosure, however, the proposed derivative action provision must contain adequate procedural safeguards to prevent nuisance suits.

The New York Not-For-Profit Corporation Law has been in effect since 1969 and provides for derivative actions by members.[270] Consequently, it may help to examine the procedural devices built into this statute to prevent nuisance suits. There, members must meet three requirements before filing a derivative action: (1) at least five percent of the members of any class must be parties to the action; (2) the plaintiff must be a member at the time the action is brought; and, (3) the complaint must set forth the efforts of the plaintiffs to secure the initiation of such action by the board or the reason for not making the request.[271]

Clearly, the first requirement, that at least five percent of the members of a class be parties to the action, is intended to guard against situations in which one member becomes unhappy with the policy of the board of directors and decides to institute a lawsuit or decides to pursue a cause of action which other members think should not be pursued. This requirement increases the likelihood that at least a significant number of members believe that some injury has been committed against the corporation and that the corpoation should be compensated. It is important that nonprofit corporation assets not be depleted by expenditures on groundless litigation, and one method of assuring the substantiality of the litigation is to require that at least five percent of the members join in a derivative action.

The second requirement, that the plaintiff must be a member at the time the action is brought, appears to be a sensible standing requirement. Why should one who is no longer a member of an organization or who has not yet joined the organization be aided by a court in suing on behalf of that organization? Since the statute grants members the right to sue derivatively it therefore should follow that one must be a current member to exercise the right.

Finally, the third requirement, that the complaint must set forth the efforts of the plaintiffs to secure the initiation of the action by the board or the reason for not making the request, is absolutely essential.

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[270]N.Y. NOT-FOR-PROFIT CORP. LAW § 623 (McKinney 1970 & Supp. 1984-85).

[271]*Id.* § 623(a), (b), (c).

The Indiana Not-For-Profit Corporation Act provides that the board of directors shall manage the affairs of the corporation.[272] Initiating a lawsuit on behalf of the corporation is a responsibility of the board of directors. Therefore, the shareholder should show why the board has refused to act or why it would be futile to make such a request of the board. Courts have held that a shareholder will be excused from making a demand upon the board when the persons being sued are members of the board.[273] In situations where the directors are not named as defendants, however, it is essential for the member to show why she has not attempted to get the board to bring the action since this is normally a board function.

Nothing in the literature on New York's law suggests that the New York courts have been overwhelmed with nuisance suits by disgruntled members of nonprofits. Consequently, it would seem that Indiana could incorporate these procedural safeguards into an amended derivative action provision. These provisions appear adequate to protect both the nonprofit and the courts from a proliferation of nuisance lawsuits.

D. Disclosure

Disclosure improves accountability, depending on what it discloses and to whom. There are at least four categories of information essential to accountability: (1) information relating to contracts between officers and the corporation and directors and the corporation; (2) information relating to executive compensation; (3) information relating to the efforts of managers to fulfill the stated goals of the corporations; (4) information relating to the extent to which the board of directors has fulfilled its duty of care.

Transactions between members, directors, and officers and the corporation must be reported to permit corporation members and the secretary of state to determine the propriety of the transactions. The activities of the corporation for the year must be carefully delineated to allow members and donors to determine whether or not the board has been sufficiently productive and to help potential beneficiaries determine which nonprofit is appropriate for particular requests for money, services, or membership. A "verified" statement of revenue and its sources must be produced to help donors, potential beneficiaries, and the general public determine how productive the nonprofit corporation's managers have been with the amount of resources they had. Most of

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[272]IND. CODE § 23-7-1.1-10 (Supp. 1985).

[273]*See, e.g.*, Barr v. Wackman, 36 N.Y.2d 371, 329 N.E.2d 180 (1975). *But see In re* Kauffman Mutual Fund Actions, 479 F.2d 257 (1st Cir. 1973), *cert. denied,* 414 U.S. 857; Aronson v. Lewis, 473 A.2d 805 (Del. 1984).

this information is required by the annual reporting requirements of the Indiana Act.[274]

The problem arises when the second part of the question is addressed, namely, to whom should disclosure be made?

In Indiana, annual reports of nonprofits must be submitted to the secretary of state.[275] Members may examine these reports at the nonprofit corporation's office.[276] Moreover, all persons, including members, may examine these reports at the office of the secretary of state.[277] Nevertheless, it is questionable whether most people know that they have this right. Furthermore, annual reports are filed at different times during the year so that it could take several trips to the secretary of state's office before the desired annual report is found on file. The Internal Revenue Code presents one solution to overcome these difficulties. In the case of annual reports filed by private foundations with the Internal Revenue Service, the foundations are required to advertise the availability of the report in a newspaper in the county in which their principal office is located.[278] The annual reports may be inspected by any citizen at the office of the nonprofit for 180 days after the report is submitted to the I.R.S.[279] This is preferable to the current disclosure procedures available in Indiana. The newspaper advertisement calls one's attention to the fact that the annual report has actually been filed and is available for inspection. Additionally, the report may be inspected at the office of the nonprofit rather than at the secretary of state's office. This may be much more convenient and could serve as incentive for constiuents to inspect the annual report.

Finally, the question remains whether disclosure in this form is adequate. Although roughly the same amount of information is required by the regulations governing nonprofit corporations as is required for business corporations, the critical difference is that financial intermediaries have an incentive to acquire the information on business corporations and disseminate it to shareholders and potential shareholders. There are no such intermediaries in the case of nonprofits. This does not imply that in some nonprofit sectors there are not commercial organizations that disseminate information to potential consumers. For example, there are commercial publications about colleges, day-care centers, and other nonprofits. It does suggest, however, that there may be a greater need for mechanisms to disseminate information about nonprofits to their constituencies. At least one jurisdiction, California, has

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[274]*See* IND. CODE § 23-7-1.1-36 (1982).

[275]*Id.*

[276]*Id.* § 23-7-1.1-13.

[277]*See id.* § 5-14-3-3 (Supp. 1985).

[278]I.R.C. § 6104(d) (1982).

[279]*Id.*

taken a step in this direction. The California Not-For-Profit Corporation Act requires large nonprofits to send copies of annual reports to their members and requires smaller nonprofits to furnish the reports on request.[280]

Indiana should follow California's lead and require all nonprofits with more than one hundred members and ten thousand dollars in assets to send copies of their annual reports to their members. Additionally, Indiana should require those nonprofits with fewer than one hundred members and assets in excess of ten thousand dollars to send annual reports to members on request. Moreover, in the interest of the broadest disclosure possible, public benefit nonprofits should be required to submit a copy of the annual report to at least one library in every county in Indiana. In summary, the content of the annual report required by the Indiana Act is adequate. The reports must, however, be circulated more widely so that each of the constituencies will at least have an opportunity to examine them.

E. Dissolution

The one clear example of overregulation in the Indiana Act is that portion of the dissolution provision that specifies how assets must be distributed. That provision states:

> * * *
> (3) Upon the authorization of the dissolution, the board of directors shall then proceed to:
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> * * *
> (IV) pay and discharge all the corporate debts and liabilities; and
> (V) after the expiration of a period of ten (10) days following the publication of this notice, distribute the remaining corporate assets and property among the members in any of the following manners or any combination thereof:
> (a) Pay any member of the corporation the amount advanced or loaned to the corporation by him, together with simple interest at the rate of six percent (6%) per annum, and no more; after which any member may receive an amount equal to the amount paid in by him as membership dues or otherwise, together with simple interest at the rate of six percent (6%) per annum and no more. If any assets remain after distribution in this manner, they shall be distributed in the manner provided in the following subsections, (b) and (c).
> (b) Transfer all of its assets or, any assets remaining after distribution in the manner provided in subsection (a), above, to

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[280]CAL. CORP. CODE § 6321 (West Supp. 1984).

any other not-for-profit corporation, organized for purposes substantially the same as those of the corporation being dissolved, if the laws, bylaws or regulations of the dissolving corporation so provide regardless of the state or law under which the distributee corporation was incorporated.

(c) Escheat to the state of Indiana all of its assets or any assets remaining after distribution as provided in either subsections (a) or (b) above. These assets shall be paid into the general treasury of the state of Indiana through payment to the treasurer of the state.[281]

The problem with the provision is the requirement that assets remaining after all steps have been complied with escheat to the state. This is a unique requirement and exists *only* in Indiana. Most jurisdictions follow the approach taken in the Model Nonprofit Corporation Act.[282] While the Model Act prohibits the distribution to members of assets "held by the corporation upon condition requiring return" and assets "subject to limitations permitting their use only for charitable . . . purposes," it does permit assets not subject to these limitations to be distributed to members upon dissolution.[283] With this provision, the Model Act probably

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[281]IND. CODE § 23-7-1.1-33 (1982).

[282]The Model Nonprofit Corporation Act provides:

The assets of a corporation in the process of dissolution shall be applied and distributed as follows:

(a) All liabilities and obligations of the corporation shall be paid and discharged, or adequate provision shall be made therefor;

(b) Assets held by the corporation upon conditions requiring return, transfer or conveyance, which condition occurs by reason of the dissolution, shall be returned, transferred or conveyed in accordance with such requirements;

(c) Assets received and held by the corporation subject to limitations permitting their use only for charitable, religious, eleemosynary, benevolent, educational or similar purposes, but not held upon a condition requiring return, transfer or conveyance by reason of the dissolution, shall be transferred or conveyed to one or more domestic or foreign corporations, societies or organizations engaged in activities substantially similar to those of the dissolving corporation, pursuant to a plan of distribution adopted as provided in this Act;

(d) Other assets, if any, shall be distributed in accordance with the provisions of the articles of incorporation or the by-laws to the extent that the aritcles of incorporation or by-laws determine the distributive rights of members, or any class or classes of members, or provide for distribution to others;

(e) Any remaining assets may be distributed to such persons, societies, organizations or domestic or foreign corporations, whether for profit or nonprofit, as may be specified in a plan of distribution adopted as provided in this Act.

MODEL NONPROFIT CORP. ACT § 46 (1964).

[283]*Id.* § 46(d), (e).

underregulates to the same extent that the Indiana Act overregulates.[284]

The Indiana Act's overregulation of nonprofit dissolutions is readily apparent. Indiana permits organizations with diverse goals to incorporate under the Indiana Not-For-Profit Corporation Act. Some of these organizations are self-serving, such as fraternities, social clubs, and labor unions. Nevertheless, they are subject to the Act's nondistribution constraint while they are going concerns. The assets of these corporations are primarily, if not exclusively, derived from contributions from members plus proceeds from fundraising activities. Rarely, if ever, do these organizations receive donations from the public. Indeed, the public has little or no expectation that these mutual benefit nonprofits will engage in charitable or public service activities.

Nevertheless, Indiana will not permit these nonprofits to distribute their assets to members on dissolution. The reasons for this prohibition are not clear. It is one thing to prohibit distribution to members when the nonprofit is an operating entity. In that instance, it is unfair to permit individuals to take advantage of the privileges accorded to nonprofits and nevertheless receive dividends. This result would not be sound public policy because it would provide an incentive for the corporation to defraud the public. Also, in the case of nonprofits such as nursing homes and day-care centers, the nonprofit corporation would have an unfair advantage over its for-profit counterparts. In the final analysis, it may be that the Indiana Act's failure to classify nonprofits has led to this overregulating provision. It does not seem an unreasonable or unwise public policy to force public benefit nonprofits to escheat their assets to the state if they cannot distribute them to nonprofits engaged in similar activities. The assets of these corporations have been contributed primarily by nonmembers with the expectation that they will be used to further the nonprofit's goals. It may have been that the Indiana legislature wanted to ensure that those associated with public benefit nonprofits had no expectation of receiving any monetary return on dissolution and therefore enacted the escheat provision as a safeguard. Nevertheless, since the legislation failed to classify nonprofits, the escheat provision applies to *all* nonprofit corporations and not just those organized for public benefit. This presents an example of overregulation.

The Indiana Act should be amended to eliminate the harshness of the escheat provision for mutual benefit nonprofits. Most jurisdictions permit members of mutual benefits to receive the assets of the organization upon dissolution. This may not be completely acceptable. The Indiana legislature should take into account the potential for abuse of the nonprofit form if nonpublic benefit nonprofits are given unfettered discretion to distribute assets to members on dissolution. Some com-

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[284] *See infra* text accompanying notes 285-86.

mercial nonprofits may have an incentive to abuse the nonprofit form. For example, there would be nothing to prevent the members of a nonprofit day-care center from operating the corporation for a period of time, charging lower rates than its for-profit counterparts in the area,[285] soliciting funds for the corporation, and then dissolving and distributing the assets to themselves. In this situation, it is not clear that the nonprofit is simply returning the members' capital to them. The members may be receiving their capital plus accumulated dividends plus funds contributed by the public. This would be clear abuse of the nonprofit form.

To eliminate the potential for such abuse, Indiana should require judicial approval of dissolution in the case of nonpublic benefit nonprofits. If the court approves the dissolution plan of the corporation and is satisfied that there has been no abuse of the privilege of using the nonprofit form, then members of nonpublic benefit nonprofits should be permitted to distribute the corporation's assets to themselves. This may also be sound public policy in the case of public benefit nonprofits. Although there should be a heavy presumption that assets committed to public benefit nonprofits are irrevocably committed for the purpose of helping the nonprofit achieve its objectives, it may be possible in some instances for members to overcome this presumption.[286]

VII. Conclusion

Ultimately, the reform measure that would greatly facilitate the implementation of the previously suggested reforms is the classification of nonprofits according to their purposes. Indiana should revise its Not-For-Profit Corporation Act to provide for two types of nonprofit corporations: Public benefit nonprofits and general purpose nonprofits. The California legislature recently adopted a new nonprofit corporation act and its definitions of these two types of nonprofits would seem adequate for Indiana's purposes. Public benefit nonprofits are defined as those corporations that further a "public or charitable" purpose.[287] California

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[285]It is possible for nonprofit businesses to charge lower rates because of their lower operating costs. Nonprofit corporations do not have to pay federal or state income tax. Some nonprofits are exempt from state sales taxation and local property taxation. Consequently, nonprofits do have a competitive advantage over their for-profit counterparts.

[286]One example of a nonprofit that could overcome such a presumption would be a family foundation which received 100% of its assets from the family. The hypothetical foundation's purpose was to reduce by half child-abuse in a local community. When the directors of the foundation concluded that the foundation had accomplished its objective, they dissolved the corporation. It would seem that on these facts the corporation could overcome the presumption that its assets were irrevocably committed to charitable purposes.

[287]Cal. Corp. Code § 5111 (West Supp. 1984).

also recognizes the mutual benefit corporation as one which "can operate for any lawful purpose that does not contemplate the distribution of gain, profits, or dividends to members, except upon dissolution."[288] Instead of using the term "mutual benefit," Indiana should use the term "general purpose" nonprofit.[289]

When nonprofits are classified, it will be considerably easier to set out those standards that are applicable to both types and those standards applicable only to one type of organization. Following this Article is a proposed revision of the Indiana Not-For-Profit Corporation Act which will demonstrate the efficacy of classification in eliminating the defects in the current Act.

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[288]*Id.* § 7111 (amended).

[289]The term "mutual benefit" implies that a group of individuals are working together for some common purpose such as to promote community understanding of political issues or to promote better working conditions. It does not quite embrace those nonprofits that are engaged in essentially commercial activities such as hospitals, day-care centers, and the many research institutes around the country. Consequently, the term "general purpose" nonprofit has been selected to try to encompass both mutual benefit and commercial nonprofit corporations.

Appendix

Proposed Revised Non-Profit Corporation Act*

Section 1. Short Title

This Act shall be known and may be cited as the Indiana Non-Profit Corporation Act.

Section 2. Definitions

As used in this chapter:

(a) "Corporation" means any corporation formed under this chapter, and includes any corporation formed before September 2, 1971, that elects to accept the provisions of this chapter by filing articles of acceptance as provided in this chapter.

(b) "Domestic corporation" means a corporation formed under the laws of this state, and the term "foreign corporation" means every other corporation.

(c) "Articles of incorporation" means both the original articles of incorporation and any and all amendments thereto (except where the original articles of incorporation only are referred to), and in the case of corporations organized before September 2, 1971, articles of acceptance filed in the office of the secretary of state and all amendments thereto.

(d) *"Nonprofit"* as applied to any corporation organized or reorganized under this chapter means any corporation which does not engage in any activities for the profit of its members and which is organized and conducts its affairs for purposes other than the pecuniary gain of its members. The term also shall include but not be limited to any religious, civil, social, educational, fraternal, charitable, or cemetery association organized or reorganized under this chapter which does not engage in any activities for the profit of its trustees, directors, incorporators, or members.

(e) "Incorporator" means one (1) of the signers of the original articles of incorporation.

(f) "Subscriber" means one who subscribes for a membership in a corporation organized or reorganized under this chapter, whether before or after incorporation.

(g) "Member" means one who has signified his intention of being a member of a corporation organized or reorganized under this chapter and who has met the requirements of the corporation for membership and who has been accepted as a member by the corporation.

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*Regular typeface denotes language currently in Indiana's Not-For-Profit Corporation Act. Italics indicates proposed additions and/or changes in the current Act.

The term includes the trustees or directors or incorporators of a corporation organized or reorganized under this chapter, and for the purposes of this chapter the corporation may organize or reorganize although it has no membership apart from its trustees, directors, and incorporators. If in any case membership in the corporation is coextensive with the trustees, directors, or incorporators of the corporation, for the purposes of this chapter the trustees, directors, or incorporators shall also constitute members within the meaning of this chapter.

(h) "Assets" includes all the property and rights of every kind of a corporation, and the term "fixed assets" means such assets as are not intended to be sold or disposed of in the ordinary course of business.

(i) "Principal office" means that place in this state designated by the corporation as its principal place of doing business, the address of which is required by this chapter to be kept on file in the office of the secretary of state.

(j) "Resident agent" means that person designated by the corporation, whose name and address is required by this chapter to be kept on file in the office of the secretary of state.

(k) "Subscription" means any written agreement or undertaking, accepted by the corporation, for a membership in the corporation.

(l) "Director" means any member of the managing board of a corporation, whether designated a director, trustee, manager, governor, or by any other title.

Section 3. Purposes

Two types of nonprofit corporations are eligible to incorporate under the provisions of the Act: (1) public benefit nonprofit corporations which may be formed for any public, charitable or religious purpose or purposes; and (2) general purpose nonprofit corporations which may be formed for any lawful purpose provided that the sole or even primary purpose is not to make profits for its members, directors, or officers.

Section 4. General Powers

(a) Each corporation shall have the capacity to act possessed by natural persons, but shall have authority to perform only those acts as are necessary, convenient or expedient to accomplish the purposes for which it is formed and such as are not repugnant to law. Nothing in this chapter shall be construed or interpreted as permitting or authorizing the transaction or conducting of a banking, railroad (other than a tourist, amusement, and non-freight-carrying railroad), utilities other than rural water or sewer systems utilities, insurance, surety, trust, safe deposit, mortgage guarantee, building and loan or credit union business.

(b) Subject to any limitations or restrictions imposed by law, or the articles of incorporation, or any amendment thereto, each corporation shall have the following general rights, privileges and powers:

(1) To continue as a corporation under its corporate name for the period limited in its articles of incorporation, or, if the period is not so limited, then perpetually;

(2) To sue and be sued in its corporate name;

(3) To have a corporate seal and to alter the same at pleasure: however, the use of a corporate seal or an impression thereeof shall not be required upon, and shall not affect the validity of any instrument whatsoever, notwithstanding the provisions of any other section of this chapter or of any other statute;

(4) To acquire, own, hold, use, lease, mortgage, pledge, sell, convey or otherwise dispose of property, real or personal, tangible or intangible;

(5) To borrow money and to issue, sell or pledge its obligations and evidences of indebtedness, and to mortgage its property and franchises to secure the payment thereof;

(6) To carry out its purposes in this state and elsewhere; to have one or more offices out of this state; and to acquire, own, hold and use, and to lease, mortgage, pledge, sell, convey or otherwise dispose of property, real or personal, tangible or intangible, out of this state;

(7) To acquire, hold, own and vote and to sell, assign, transfer, mortgage, pledge, or otherwise dispose of the capital stock, bonds, securities or evidences of indebtedness of any other corporation, domestic or foreign, insofar as the same shall be consistent with the purposes of the corporation;

(8) To appoint such officers and agents as the affairs of the corporation may require and to define their duties and fix their compensation;

(9) To indemnify any director or officer or former director or officer of the corporation, or any person who may have served at its request as a director or officer of another corporation, against expenses actually and reasonably incurred by him in connection with the defense of any civil action, suit or proceeding in which he is made or threatened to be made, a party by reason of being or having been a director or officer, except in relation to matters as to which he is adjudged in the action, suit or proceeding to be liable for negligence or misconduct in the performance of duty to the corporation: However, the indemnification is not exclusive and does not impair any other rights those indemnified may have under any provision of the articles of incorporation, by-laws, resolution, or other authorization adopted, after notice, by a majority of the members voting at an annual meeting; and provided further that expenses incurred in defending any action, suit, or proceeding, civil or criminal,

may be paid by the corporation in advance of the final disposition of such action, suit, or proceeding notwithstanding any provisions of this article to the contrary upon receipt of an undertaking by or on behalf of the director, officer, employee, or agent to repay the amount paid by the corporation if it shall ultimately be determined that the director, officer, employee, or agent is not entitled to indemnification as provided in this section;

(10) To purchase and maintain insurance on behalf of any person who is or was a director, officer, employee or agent of the corporation, or is or was serving at the request of the corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise against any liability asserted against him and incurred by him in any such capacity, or arising out of his status as such, whether or not the corporation would have the power to indemnify him against liability under the provisions of this section;

(11) To make by-laws for the government and regulation of its affairs;

(12) To cease its activities and to dissolve and surrender its corporate franchise; and

(13) To do all acts and things necessary, convenient or expedient to carry out the purposes for which it is formed.

(c) No corporation shall, by any implication or construction, possess the power of engaging in any activities for the purpose of or resulting in the pecuniary remuneration to its members as such, but this provision shall not prohibit reasonable compensation to members for services actually rendered; nor shall the corporation be prohibited from engaging in any undertaking for profit so long as such undertaking does not inure to the profit of its members.

Section 5. Corporate Name

(a) The corporate name of every corporation that is organized under this chapter, and of every corporation which accepts the provisions of this chapter, shall include the word "Corporation" or "Incorporated", or one of the abbreviations thereof.

(b) A corporation that is organized under this chapter or which accepts the provisions of this chapter:

(1) may not use as a part of its corporate name any word or phrase which indicates or implies any purpose or power not possessed by corporations organizable under this chapter; and

(2) shall take a corporate name that is, upon the records of the secretary of state, distinguishable from the name of any other corporation then existing under the laws of this state or authorized to transact business in this state and distinguishable from any name to which another person has obtained exclusive rights under

subsection (c). However, a corporation may take a name that is not distinguishable from the name of another corporation if at the same time:

(A) the other corporation changes its corporate name, or dissolves or withdraws from transacting business in this state or ceases to exist; or

(B) the written consent of the other corporation, signed by any current officer of the corporation and verified and affirmed subject to penalties for perjury, is filed with the secretary of state.

(c) Any person intending to organize a corporation, any domestic corporation intending to change its name, any foreign corporation intending to make appliation for a certificate of admission to transact business in this state or authorized to transact business in this state and intending to change its name, and any person or persons intending to organize a foreign corporation and make application for a certificate of admission to transact business in this state may reserve the exclusive right to the use of a corporate name, except as hereinbefore provided, for a period of one hundred twenty (120) days, by filing in the office of the secretary of state a notice of intention and specifying the name, and paying the fee prescribed by IC 23-3-2-2(o).

(d) Subject to the provisions of this section, any corporation may change its corporate name at any time by amending its articles of incorporation in the manner hereafter provided.

Section 6. Principal Office; Resident Agent

(a) Each corporation shall maintain an office or place of business in this state, to be known as the "principal office", and have an officer or agent resident in this state designated as the resident agent of the corporation. The post office address of the principal office and the name and post office address of the resident agent must be stated in the original articles of incorporation at the time of incorporation. Thereafter, the location of the principal office or the designation of the resident agent, or both, may be changed:

(1) at any time, when authorized by the board of directors, by filing with the secretary of state on or before the day any such change is to take effect; or

(2) if within five (5) days after the death of the resident agent or other unforeseen termination of his agency, a certificate is filed, signed by any current officer of the corporation and verified and affirmed subject to penalties of perjury, stating the change to be made and reciting that this change is made pursuant to authorization by the board of directors.

(b) If the resident agent for one (1) or more corporations changes address, the agent may change the address on file with the secretary

of state by filing in the office of the secretary of state a statement setting forth:

(1) the names of the corporations for which the change is effective;

(2) the old and new addresses of the resident agent; and

(3) the date on which the change is effective.

If the old and new addresses of the resident agent are the same as the old and new addresses of the principal office of the corporations, the statement may include a change of address of the principal office of the corporations.

(c) A resident agent who files a statement under subsection (b) shall first notify in writing each corporation for which the agent is resident agent that the statement will be filed, and the statement must recite the fact that this notice has been given. The statement shall be executed and verified in duplicate and affirmed subject to penalties of perjury by the resident agent in his individual name; however, if the resident agent is a foreign or domestic corporation, the statement must be executed by a current officer of the corporation and verified and affirmed subject to penalties of perjury. The statement, executed in duplicate, shall be delivered to the secretary of state. If he finds that it conforms to the requirements of law, the secretary of state shall, upon payment of the required fees, endorse upon each of the duplicates tendered for filing, over his signature and offical seal, the word "filed" followed by the date of the filing. The secretary of state shall retain one (1) executed copy of the statement in his files. He shall attach to the other filed copy a certificate stating that the instrument is an executed copy of the statement filed in his office, giving the date of the filing, and shall return the other copy to the resident agent.

(d) Any person who has been designated by a corporation as its resident agent for service of process may file with the secretary of state a signed statement that he is unwilling to continue to act as resident agent for the corporation for the service of process. The secretary of state shall forthwith give written notice, by mail, to the corporation, of the filing of this statement and its effect, which notice shall be sent to the corporation at its principal office or place of business as shown in the records of his office. Five (5) days after the filing of this statement with the secretary of state, the person's responsibility as agent shall terminate. If and when the corporation shall not have available in this state its resident agent as hereinbefore provided, service of legal process upon such corporation, in all instances in which such service could be made on such agent if available, may be had by serving the secretary of state upon the same terms and provisions as provided in IC 23-1-11-6.

Section 7. By-Laws

The power to make, alter, amend or repeal the by-laws of a corporation shall be vested in its board of directors unless otherwise provided in the articles of incorporation. The by-laws may contain any provision for the regulation and management of the affairs of the corporation not inconsistent with the articles of incorporation and the laws of this state, including provisions respecting: the time and place of holding and the manner of conducting meetings of members; the manner of calling special meetings of members or directors; the powers, duties, tenure and qualifications of officers and directors of the corporation and the time, place and manner of electing them; requirements for bonding officers or employees; the form of membership certificates and the manner of creating the exercising proxies.

Section 8. Members

A corporation may have one or more classes of members. Public benefit corporations may choose to have no members. If the corporation has one or more classes of members, the designation of such class or classes, the manner of election or appointment and the qualifications and rights of the members of each class shall be set forth in the articles of incorporation or the by-laws. If, in the case of public benefit corporations, the corporation has no members, that fact shall be set forth in the articles of incorporation or the by-laws. A corporation may issue certificates evidencing membership therein. The members, directors, officers and employees shall not, as such, be liable for the corporation's obligations except to the extent of their contributions to the corporation.

Section 9. Meetings of Members

Meeting of members may be held at such place, either within or without this state, as may be provided in the bylaws. In the absence of any such provision, all such meetings shall be held at the registered office of the corporation in this state.

An annual meeting of the members shall be held at such time as may be provided in the by-laws. Failure to hold the annual meeting shall not work a forfeiture or dissolution of the corporation.

Special meetings of the members may be called by the president or by the board of directors. Special meetings may also be called by such other officers or persons or number or proportion of members as may be provided in the articles of incorporation or the by-laws. In the absence of a provision fixing the number or proportion of members entitled to call a meeting, a special meeting of members may be called by members having one-twentieth of the votes entitled to be cast at such meeting.

Section 10. Notice of Members' Meetings

Unless otherwise provided in the articles of incorporation or the by-laws, written notice stating the place, day and hour of the meeting and, in case of a special meeting, the purpose or purposes for which the meeting is called, shall be delivered not less than ten or more than fifty days before the date of the meeting, either personally or by mail, by or at the discretion of the president or by the secretary, or the officers or persons calling the meeting, to each member entitled to vote at such meeting. If mailed, such notice shall be deemed to be delivered when deposited in the United States mail addressed to the member at his or her address as it appears on the records of the corporation, with postage thereon prepaid.

Section 11. Voting

The right of the members, or any class or classes of members, to vote may be limited, enlarged or denied to the extent specified in the articles of incorporation or the by-laws. Unless so limited, enlarged or denied, each member, regardless of class, shall be entitled to one vote on each matter submitted to a vote of members.

A member entitled to vote may vote in person or, unless the articles of incorporation or the by-laws otherwise provide, may vote by proxy executed in writing by the member or by his duly authorized attorney-in-fact. No proxy shall be valid after eleven months from the date of its execution, unless otherwise provided in the proxy. Where directors or officers are to be elected by members, the by-laws may provide that such elections may be conducted by mail.

The articles of incorporation or the by-laws may provide that in all elections for directors every member entitled to vote shall have the right to cumulate his vote and to give one candidate a number of votes equal to his vote multiplied by the number of directors to be elected, or by distributing such votes on the same principle among any number of such candidates.

If a corporation has no members or its members have no right to vote, the directors shall have the sole voting power.

Section 12. Quorum

The by-laws may provide the number or percentage of members entitled to vote represented in person or by proxy, or the number or percentage of votes represented in person or by proxy, which shall constitute a quorum at a meeting of members. In the absence of any such provision, members holding one-tenth of the votes entitled to be cast on the matter to be voted upon represented in person or by proxy shall constitute a quorum. A majority of the votes entitled to be cast on a matter to be voted upon by the members present or

represented by proxy at a meeting at which a quorum is present shall be necessary for the adoption thereof unless a greater proportion is required by this Act, the articles of incorporation or the by-laws.

Section 13. Members' Derivative Actions

(a) A member of any corporation incorporated under this chapter shall have the right to maintain an action on behalf of the corporation.

(b) No action may be instituted or maintained in the right of any corporation by any member of such corporation unless all three of the following conditions exist:

(1) The plaintiffs allege in the complaint that they were members at the time of the transaction or any part thereof of which plaintiffs complain, or that plaintiffs' memberships thereafter devolved upon plaintiffs by operation of law from holders who were holders at the time of the transaction or any part thereof complained of; and

(2) The plaintiffs represent at least five percent (5%) of the membership of the corporation or of a particular class of members of the corporation; and

(3) The plaintiffs allege in the complaint with particularity plaintiffs' efforts to secure from the board such action as plaintiffs desire, or the reasons for not making such effort, and allege further that plaintiffs have either informed the board in writing of the ultimate facts of each cause of action against each defendant or delivered to the corporation or the board a true copy of the complaint which plaintiffs propose to file.

Section 14. Directors

(a) The affairs of every corporation shall be managed by a board of directors who may be members of the corporation, with such other qualifications as the bylaws may prescribe.

(b) The exact number of directors, or in lieu thereof the minimum and maximum number of directors, shall be prescribed in the articles of incorporation, but under no circumstances shall the minimum number of directors be less than three (3). However, the exact number of directors shall be prescribed from time to time in the by-laws of the corporation and may be either the minimum number or the maximum number or any number in between as prescribed in the articles of incorporation.

(c) In the event the number of directors is increased by the by-laws of any corporation, the election of the additional director or directors shall be by a vote of the members of the corporation.

(d) Each director shall serve for that period of time stipulated in the articles of incorporation. Where the articles of incorporation es-

tablish no term of office, each director shall serve not more than three (3) years, or until his successor is elected and qualified.

(e) When the board of directors consists of nine (9) or more members, the articles of incorporation may provide that the directors shall be divided into two (2) or more groups whose terms of office shall expire at different times, however, no term shall continue longer than three (3) years.

(f) Any vacancy occurring on the board of directors caused by a death, resignation, or otherwise, shall be filled until the next annual meeting through a vote of a majority of the remaining members of the board. A majority of the entire board of directors shall be necessary to constitute a quorum. However, when filling vacancies a majority of the existing directors shall be required for a quorum. However, the bylaws of any corporation may prescribe that a lesser number than the majority of the entire board may constitute a quorum, but the number shall not be less than one-third (1/3) of the total number of directors and in no case shall be less than two (2) directors. The act of a majority of the directors present at a meeting who constitute a quorum shall be the act of the board of directors.

(g) Meetings of the board of directors may be held upon such notice as may be provided in the articles of incorporation or the bylaws. Unless otherwise provided by the articles of incorporation or bylaws, any or all of the board of directors or of a committee designated by the board may participate in a meeting of the board or committee by means of a conference telephone or similar communications equipment by which all persons participating in the meeting can communicate with each other, and participation in this manner constitutes presence in person at the meeting.

(h) The board of directors may, by resolution adopted by a majority of the entire board pursuant to a provision of the bylaws, designate two (2) or more members of the corporation to constitute an executive committee, which to the extent provided in the resolution or in the bylaws, shall have and exercise all of the authority of the board of directors in the management of the corporation; but the designation of a committee and the delegation of authority to it, shall not operate to relieve the board of directors or any member thereof of any responsibility imposed upon it or him by this chapter.

(i) Unless otherwise provided by the articles of incorporation or bylaws, any action required or permitted to be taken at any meeting of the board of directors or of any committee thereof may be taken without a meeting, if prior to such action a written consent to such action is signed by all members of the board or of such committee, as the case may be, and such written consent is filed with the minutes of proceedings of the board or committee.

Section 15. Officers

The officers of a corporation shall be chosen by the board of directors at a time, in a manner, and for the terms and with the title which the by-laws may prescribe; however, the articles of incorporation or by-laws may also provide that officers are to be elected by the members of the corporation instead of by the board of directors. Each officer shall hold office until his successor is chosen and qualified. If the by-laws so provide, any two (2) or more offices may be held by the same person, except that the duties of the president and secretary shall not be performed by the same person.

All officers and agents of the corporation between themselves and the corporation shall have the authority and perform any duties in the management of the property and affairs of the corporation as may be provided in the by-laws, or, in the absence of any provision, as may be determined by resolution of the board of directors. Any officer or agent may be removed by the board of directors whenever, in its judgment, the best interests of the corporation will be served but this removal shall be without prejudice to the contract rights, if any, of the person removed. Election or appointment of an officer or agent shall not of itself create contract rights.

Section 16. Standards of Conduct

(a) Public Benefit Corporations. A director shall perform the duties of a director, including duties as a member of any committee of the board upon which the director may serve, in the utmost good faith and loyalty, in a manner such director believes to be in the best interest of the corporation and with such care, including the utmost reasonable inquiry, as an ordinarily prudent director in a like position would use under similar circumstances.

(b) General Purpose Corporations. A director shall perform the duties of a director, including duties as a member of any committee of the board upon which the director may serve, in good faith, in a manner such director believes to be in the best interests of the corporation and with such care, including reasonable inquiry, as an ordinarily prudent person in a like position would under similar circumstances.

(c) Public Benefit and General Purpose Corporations. In performing the duties of a director, a director shall be entitled to rely on information, opinions, reports or statements, including financial statements and other financial data, in each case prepared or presented by:

(1) One or more officers or employees of the corporation whom the director believes to be reliable and competent in the exercise of their duties; or

(2) Counsel, independent accountants or other persons as to matters which the director believes to be within such person's professional or expert competence; or

(3) A committee of the board upon which the director does not serve, as to matters within its designated authority, which committee the director believes to merit confidence;

so long as, in any such case, the director acts in utmost good faith in the case of Public Benefit Corporations and in good faith in the case of General Purpose Corporations, after reasonable inquiry when the need therefor is indicated by the circumstances and without knowledge that would cause such reliance to be unwarranted.

Section 17. Self-Dealing Transactions

(1) Public Benefit Corporations.

(a) Except as provided in subdivision (b), for the purpose of this section, a self-dealing transaction means a transaction to which the corporation is a party and in which one or more of its directors has a material financial interest and which does not meet the requirements of paragraph (1), (2), or (3) of subdivision (d). Such a director is an "interested director" for the purpose of this section.

(b) The provisions of this section do not apply to any of the following:

(1) An action of the board fixing the compensation of a director as a director or officer of the corporation.

(2) A transaction which is part of a public or charitable program of the corporation if it: (i) is approved or authorized by the corporation in good faith and without unjustified favoritism; and (ii) results in a benefit to one or more directors or their families because they are in the class of persons intended to be benefited by the public or charitable program.

(3) A transaction, of which the interested director or directors have no actual knowledge, and which does not exceed the lesser of 1 percent of the gross receipts of the corporation for the preceding fiscal year or one hundred thousand dollars ($100,000).

(c) The Attorney General or, if the Attorney General is joined as an indispensable party, any of the following may bring an action in the superior court of the proper county for the remedies specified in subdivision (h):

(1) The corporation, or a member asserting the right in the name of the corporation pursuant to Section 13.

(2) A director of the corporation.

(3) An officer of the corporation.

(4) Any person granted relator status by the Attorney General.

(d) In any action brought under subdivision (c) the remedies specified in subdivision (h) shall not be granted if:

(1) The Attorney General, or the court in an action in which the Attorney General is an indispensable party, has approved the transaction before or after it was consummated; or

(2) The following facts are established:

(A) The corporation entered into the transaction for its own benefit;

(B) The transaction was fair and reasonable as to the corporation at the time the corporation entered into the transaction;

(C) Prior to consummating the transaction or any part thereof the board authorized the transaction in good faith by a vote of a majority of the directors then in office without counting the vote of the interested director or directors, and with knowledge of the material facts concerning the transaction and the director's interest in the transaction. Except as provided in paragraph (3) of this subdivision, action by a committee of the board shall not satisfy this paragraph; and

(D)(i) Prior to authorizing or approving the transaction the board considered and in good faith determined after reasonable investigation under the circumstances that the corporation could not have obtained a more advantageous arrangement with reasonable effort under the circumstances or (ii) the corporation in fact could not have obtained a more advantageous arrangement with reasonable effort under the circumstances; or

(3) The following facts are established:

(A) A committee or person authorized by the board approved the transaction in a manner consistent with the standards set forth in paragraph (2) of this subdivision;

(B) It was not reasonably practicable to obtain approval of the board prior to entering into the transaction; and

(C) The board, after determining in good faith that the conditions of subparagraphs (A) and (B) of this paragraph were satisfied, ratified the transaction at its next meeting by a vote of the majority of the directors then in office without counting the vote of the interested director or directors.

(e) Except as provided in subdivision (f), an action under subdivision (c) must be filed within two years after written notice setting forth the material facts of the transaction and the director's interest in the transaction is filed with the Attorney General in accordance with such regulations, if any, as the Attorney General may adopt or, if no such notice is filed, within three years after the transaction occurred, except for the Attorney General, who shall have 10 years after the transaction occurred within which to file an action.

(f) In any action for breach of an obligation of the corporation owed to an interested director, where the obligation arises from a self-dealing transaction which has not been approved as provided in sub-

division (d), the court may, by way of offset only, make any order authorized by subdivision (h), notwithstanding the expiration of the applicable period specified in subdivision (e).

(g) Interested directors may be counted in determining the presence of a quorum at a meeting of the board which authorizes, approves or ratifies a contract or transaction.

(h) If a self-dealing transaction has taken place, the interested director or directors shall do such things and pay such damages as in the discretion of the court will provide an equitable and fair remedy to the corporation, taking into account any benefit received by the corporation and whether the interested director or directors acted in good faith and with intent to further the best interest of the corporation. Without limiting the generality of the foregoing, the court may order the director to do any or all of the following:

(1) Account for any profits made from such transaction, and pay them to the corporation;

(2) Pay the corporation the value of the use of any of its property used in such transaction; and

(3) Return or replace any property lost to the corporation as a result of such transaction, together with any income or appreciation lost to the corporation by reason of such transaction, or account for any proceeds of sale of such property, and pay the proceeds to the corporation together with interest at the legal rate.

(2) General Purpose Corporations.

(a) No contract or other transaction between a corporation and one or more of its directors, or between a corporation and any domestic or foreign corporation, firm or association in which one or more of its directors has a material financial interest, is either void or voidable because such director or directors or such other corporation, business corporation, firm or association are parties or because such director or directors are present at the meeting of the board or a committee thereof which authorizes, approves or ratifies the contract or transaction, if:

(1) The material facts as to the transaction and as to such director's interest are fully disclosed or known to the members and such contract or transaction is approved by the members in good faith, with any membership owned by any interested director not being entitled to vote thereon;

(2) The material facts as to the transaction and as to such director's interest are fully disclosed or known to the board or committee, and the board or committee authorizes, approves or ratifies the contact or transaction in good faith by a vote sufficient without counting the vote of the interested director or directors and the contract or transaction is just and reasonable as to the corporation at the time it is authorized, approved or ratified; or

(3) As to contracts or transactions not approved as provided in paragraph (1) or (2) of this subdivision, the person asserting the validity of the contract or transaction sustains the burden of proving that the contract or transaction was just and reasonable as to the corporation at the time it was authorized, approved or ratified.

A mere common directorship does not constitute a material financial interest within the meaning of this sub-division. A director is not interested within the meaning of this subdivision in a resolution fixing the compensation of another director as a director, officer or employee of the corporation, notwithstanding the fact that the first director is also receiving compensation from the corporation.

(b) No contract or other transaction between a corporation and any corporation, business corporation or association of which one or more of its directors are directors is either void or voidable because such director or directors are present at the meeting of the board or a committee thereof which authorizes, approves or ratifies the contract or transaction, if:

(1) The material facts as to the transaction and as to such director's other directorship are fully disclosed or known to the board or committee, and the board or committee authorizes, approves or ratifies the contract or transaction in good faith by a vote sufficient without counting the vote of the common director or directors or the contract or transaction is approved by the members in good faith; or

(2) As to contracts or transactions not approved as provided in paragraph (1) of this subdivision, the contract or transaction is just and reasonable as to the corporation at the time it is authorized, approved or ratified.

This subdivision does not apply to contracts or transactions covered by subdivision (a).

Section 18. Books and Records

All corporations shall keep full and complete books and records which shall show, at all times, the financial condition of the corporation and a separate financial account of each member. All books and records of any nature whatsoever of any corporation shall be open for inspection by any member, for proper purposes, at any reasonable time.

Section 19. Earnings

No member of any corporation organized or reorganized under this chapter shall have or receive any earnings from such corporation, except a member who is an officer, director, or employee of such corporation, in which event he may receive fair and reasonable compensation for his services as officer, director, or employee and a

member may also receive principal and interest on monies loaned or advanced to the corporation as hereinbefore provided.

Section 20. Loans To Officers

No corporation shall make any advancement for services to be performed in the future or shall make any loan of money or property to any officer or director of the corporation.

Section 21. Incorporators

One (1) or more persons, or a domestic or foreign corporation, may act as incorporator or incorporators of a corporation by signing, acknowledging and delivering, in duplicate, to the secretary of state articles of incorporation for the corporation.

Section 22. Articles of Incorporation

When the provisions of section 17 of this chapter have been complied with, the incorporators shall execute and file, in the manner hereafter provided, articles of incorporation setting forth the following:

(1) The name of the proposed corporation;

(2) The purpose or purposes for which it is being formed;

(3) The period of time during which it is to continue as a corporation, if the time is to be limited;

(4) The post-office address of its principal office and the name and address of its resident agent;

(5) A definite, concise and complete statement of its classes of members and a statement of the relative rights, preferences, limitations and restrictions of each class thereof, together with a statement of the voting rights of each class;

(6) The number of directors constituting the initial board of directors;

(7) The names and addresses of the first board of directors;

(8) The names and addresses of the incorporators;

(9) A statement of the property and an estimate of its value, to be taken over by the corporation at or upon its incorportion;

(10) Any other provision, consistent with the laws of the state, for the regulation of the affairs of the corporation, and creating, defining, limiting or regulating the powers of the corporation, of the board of directors or of its members.

The articles of incorporation shall be prepared and signed in duplicate in and upon the form prescribed by the secretary of state, signed by the incorporator and verified and affirmed subject to penalties for perjury and shall be presented in duplicate to the secretary of state at his office, accompanied by the fees prescribed by law.

Section 23. Certificate of Incorporation—Issuance

Upon the presentation of the articles of incorporation, if the secretary of state finds they conform to law, he shall indorse his approval upon the duplicate of the articles, and, when all fees required by law have been paid, shall file one (1) copy of the articles in his office and issue a certificate of incorporation to the incorporators. The certificate of incorporation, together with the remaining copy of the articles bearing the indorsement of his approval, shall be returned by him to the incorporators or their representatives.

Section 24. Certificate of Incorporation—Effect

Upon the issuance of the certificate of incorporation by the secretary of state, the corporate existence shall begin, all subscribers for membership shall be deemed accepted by the corporation and the subscribers shall be deemed members of the corporation.

The certificate of incorporation issued by the secretary of state shall be conclusive evidence of the fact that the corporation has been incorporated; but proceedings may be instituted by the state to dissolve, wind up and terminate a corporation which should not have been formed under this chapter or which has begun business without a substantial compliance with the conditions prescribed by this chapter.

Section 25. Adoption of By-Laws

If the articles of incorporation provide for the adoption of by-laws by the members, the incorporators or a majority of them, after the issuance of the certificate of incorporation, shall call a meeting of the members for the purpose of adopting the by-laws, giving at least ten (10) days' notice by mail to each member of the time and place of the meeting, unless this notice is waived in writing by any or all of the members, in which cases the notice shall be given only to those who have not waived notice. The members shall meet at the time and place designated and shall adopt the by-laws. After the adoption of the by-laws, the directors named in the articles of incorporation as the first board of directors shall meet at the request of a majority of them and shall elect officers and transact any other business which may properly come before the board.

If the articles of incorporation do not provide for the adoption of the by-laws by the members, then, after the isssuance of the certificate of incorporation, the directors, named in the articles of incorporation as the first board of directors, shall meet at the request of a majority of them, adopt the by-laws, elect officers and transact any other business which may properly come before the board.

Section 26. Amendment of Articles—Authority

A corporation may at any time amend its articles of incorporation without limitation so long as the articles as amended would have been authorized by this chapter as original articles, by complying with the provisions of sections 23 through 25 of this chapter.

Section 27. Amendment of Articles—Proposal—Adoption

Every amendment to the articles of incorporation shall first be proposed by the board of directors by the adoption of a resolution setting forth the proposed amendment and directing that it be submitted to a vote of the members entitled to vote in respect thereof at a designated meeting of the members, which may be an annual meeting or a special meeting of the members. If the resolution shall direct that the proposed amendment is to be submitted at an annual meeting, notice of the submission of the proposed amendment shall be included in the notice of the annual meeting. If the resolution shall direct that the proposed amendment is to be submitted at a special meeting, this special meeting shall be called by the resolution proposing the amendment, and notice of the meeting shall be given at the time and in the manner provided in section 9 of this chapter.

An amendment so proposed shall be adopted upon receiving the affirmative votes of a majority of the votes entitled to be cast in regard to the amendment unless the articles of incorporation or bylaws require a larger proportion of votes.

Section 28. Amendment of Articles—Members Entitled to Vote

The members entitled to vote in respect to proposed amendments to articles of incorporation shall be determined as follows:

(a) In addition to the members entitled by the articles of incorporation to vote upon amendments, the members of a class shall be entitled to vote as a class on a proposed amendment, if the amendment would:

(1) Authorize the board of directors to fix or alter by resolution the classes of members or the relative rights, preferences, qualifications, limitations or restrictions of any class or classes, or would revoke such authority of the board of directors.

(2) Change the designations, preferences, limitations or relative rights of the members of such class.

(3) Create a new class of members having rights and preferences prior and superior to the members of that class, or increase the rights and preferences of any class having them prior to or superior to the members of the class.

(b) As to all other proposed amendments, only the members who by the terms of the articles of incorporation are entitled to vote thereon, shall be entitled to vote in respect to the amendments.

Section 29. Articles of Amendment—Content—Filing

Upon the proposal and adoption of any amendment to the articles of incorporation, there shall be executed and filed, in the manner hereinafter provided, articles of amendment setting forth the following:

(a) The amendment so adopted.

(b) The manner of its adoption and the vote by which it was adopted.

Upon the adoption of any amendment, a corporation may file amended articles in the office of the secretary of state in lieu of the aforementioned articles of amendment. The amended articles, which may differ from the previously existing articles in the respects authorized by the resolution of amendment, shall contain a statement that they supersede and take the place of the previously existing articles of the corporation, and shall also contain all the statements required by this chapter, to be included in the original articles.

In lieu of stating the names and addresses of the first board of directors in amended articles, they shall state the names and addresses of the directors holding office at the time of adoption of the amended articles. In lieu of stating the names and addresses of the incorporators in amended articles, they shall state the names and addresses of the president or vice-president and secretary or assistant secretary of the corporation.

The articles of amendment or amended articles shall be prepared and signed in duplicate, in the form prescribed by the secretary of state, by any current officer of the corporation and verified and affirmed subject to penalties for perjury, and shall be presented in duplicate to the secretary of state, at his office, accompanied by the fees prescribed by law.

Section 30. Certificate of Amendment

Upon the presentation of the articles of amendment or amended articles, the secretary of state, if he finds that they conform to law, shall indorse his approval upon both of the duplicate copies of the articles of amendment or amended articles, and, when all fees have been paid as required by law, shall file one (1) copy of the articles of amendment or amended articles in his office, issue a certificate of amendment to the corporation, and shall return it to the corporation, together with the copy of the articles of amendment or amended articles, bearing the indorsement of his approval.

Section 31. Effect of Certificate of Amendment

Upon the issuance of the certificate of amendment by the secretary of state, the amendment shall become effective and the articles of incorporation shall be deemed amended accordingly.

If amended articles are filed and approved as herein provided, the secretary of state shall, upon request, certify a copy of them, or in the alternative, certify all or any part of the articles of incorporation, amendment, merger, consolidation, dissolution or amended articles, or other papers of the corporation, lawfully received and filed by him.

No amendment shall affect any existing cause of action in favor of or against the corporation, or any pending suit in which the corporation shall be a party, or the existing rights of persons other than members; and, in the event the corporate name shall be changed by any amendment no suit brought against the corporation under its former name shall be abated for that reason.

Section 32. Change of Corporate Name

(a) Whenever any corporation amends its articles of incorporation to change its corporate name, it shall, within ten (10) days after the issuance of the certificate of amendment, file for record, with the county recorder of each county in this state in which it has real property at the time the amendment becomes effective, a duplicate of the certificate of amendment, duly certified by the secretary of state under the seal of his office.

(b) Whenever any corporation shall restate its articles of incorporation in articles of acceptance so as to change its corporate name, a duplicate certificate of acceptance, duly certified by the secretary of state under the seal of his office, shall be filed for record, within ten (10) days after the issuance of the certificate of acceptance, with the county recorder of each county in this state in which the corporation has any real property at the time the certificate is issued.

(c) Whenever any corporation is a party to a merger or consolidation, the surviving or new corporation, as the case may be, shall, within ten (10) days after the merger or consolidation becomes effective, file for record with the county recorder of each county in this [sic] in which any of such corporations own real property at the time of the merger or consolidation the title to which will be transferred by the merger or consolidation, a duplicate of the certificate of merger or consolidation, certified by the secretary of state under the seal of his office.

Section 33. Sale of Entire Assets

Any corporation may, at any time, if otherwise lawful, sell, lease, exchange, mortgage, pledge, or otherwise dispose of all or substan-

tially all of its fixed assets, for the purpose of terminating and winding up, or changing the nature of its business (such a sale, lease, exchange, mortgage, pledge or other disposition for such purpose being referred to in this chapter as a "Special Corporate Transaction"), upon any terms and conditions and for any consideration, including shares in other corporations, as it deems necessary to comply with the provisions of this chapter.

Section 34. Special Corporate Transaction— Proposals By Directors— Notice To Members

Any special corporate transaction shall first be proposed by the board of directors by the adoption of a resolution setting forth the terms and conditions of this transaction and directing that it be submitted to a vote of the members at a designated meeting, which may be an annual meeting or a special meeting of those members entitled to vote. If the designated meeting at which this special corporate transaction is to be submitted, is an annual meeting, notice of the submission of this transaction shall be included in the notice of the annual meeting. If this same transaction is to be submitted at a special meeting of members entitled to vote, the special meeting shall be called by a resolution designating the meeting, and notice of this meeting shall be given at the time and in the manner provided in section 9 of this chapter. *In the case of corporations formed without members, the vote of the board of directors shall be final.*

Section 35. Special corporate Transactions— Authorization By Members

The proposed special corporate transaction shall then be submitted to a vote of the members entitled to vote in respect thereof at the annual or special meeting directed by the resolution of the board of directors proposing such special corporate transaction, and shall be authorized upon receiving the affirmative votes of a majority of the members entitled to vote in respect thereof. Unless otherwise provided in the articles of incorporation if the members of any class are entitled to vote as a class, the proposal shall be adopted upon receiving the affirmative vote of the required percentage of the members of each class entitled to vote thereon as a class, and of the total members entitled to vote thereon.

The members of any corporation entitled to vote in respect to a proposed special corporate transaction shall be the members which by the articles of incorporation of such corporation are entitled to vote in questions involving such special corporate transaction.

Section 36. Special Corporate Transactions—Abandonment by Directors

After authorization by a vote of the members, the board of directors, nevertheless, in its discretion, may abandon the special corporate transaction, subject to the rights of third parties under any related contracts without further action or approval by the members.

Section 37. Voluntary Dissolution

A corporation may dissolve and wind up its affairs in the following manner:

(a) If there are members entitled to vote thereon, the board of directors shall adopt a resolution recommending that the corporation be dissolved, and directing that the question of such dissolution be submitted to a vote at a meeting of members entitled to vote thereon, which may be either an annual or a special meeting. Written notice stating that the purpose, or one of the purposes, of such meeting is to consider the advisability of dissolving the corporation, shall be given to each member entitled to vote at such meeting, within the time and in the manner provided in this Act for the giving of notice of meetings of members. A resolution to dissolve the corporation shall be adopted upon receiving at least two-thirds of the votes which members present at such meeting or represented by proxy are entitled to cast.

(b) If there are no members, or no members entitled to vote thereon, the dissolution of the corporation shall be authorized at a meeting of the board of directors upon the adoption of a resolution to dissolve by the vote of a majority of the directors in office.

Upon the adoption of such resolution by the members, or by the board of directors if there are no members or no members entitled to vote thereon, the corporation shall cease to conduct its affairs except in so far as may be necessary for the winding up thereof, shall immediately cause a notice of the proposed dissolution to be mailed to each known creditor of the corporation, and shall proceed to collect its assets and apply and distribute them as provided in this Act.

Section 38. Distribution of Assets

The assets of a corporation in the process of dissolution shall be applied and distributed as follows:

(a) All liabilities and obligations of the corporation shall be paid and discharged, or adequate provision shall be made therefor;

(b) Assets held by the corporation upon condition requiring return, transfer or conveyance, which condition occurs by reason of the dissolution, shall be returned, transferred or conveyed in accordance with such requirements;

(c) Assets received and held by the corporation subject to limitations permitting their use only for chartiable, religious, eleemosynary, benevolent, educational or similar purposes, but not held upon a condition requiring return, transfer or conveyance by reason of the dissolution, shall be transferred or conveyed to one or more domestic or foreign corporations, societies or organizations engaged in activities substantially similar to those of the dissolving corporation, pursuant to a plan of distribution adopted as provided in this Act;

(d) Other assets, if any, shall be distributed in accordance with the provisions of the articles of incorporation or by-laws to the extent that the articles of incorporation or by-laws determine the distributive rights of members, or any class or classes of members, or provide for distribution to others;

(e) Any remaining assets may be distributed to such persons, societies, organizations or domestic or foreign corporations, whether for profit or non-profit, as may be specified in a plan of distribution adopted as provided in this Act.

Section 39. Plan of Distribution

A plan providing for the distribution of assets, not inconsistent with the provisions of this Act, may be adopted by a corporation in the process of dissolution and shall be adopted by a corporation for the purpose of authorizing any transfer or conveyance of assets for which this Act requires a plan of distribution, in the following manner:

(a) If there are members entitled to vote thereon, the board of directors shall adopt a resolution recommending a plan of distribution and directing the submission thereof to a vote at a meeting of members entitled to vote thereon, which may be either an annual or a special meeting. Written notice setting forth the proposed plan of distribution or a summary thereof shall be given to each member entitled to vote at such meeting, within the time and in the manner provided in this Act for the giving of notice of meetings of members. Such a plan of distribution shall be adopted upon receiving at least two-thirds of the votes which members present at such meeting or represented by proxy are entitled to cast.

(b) If there are no members, or no members entitled to vote thereon, a plan of distribution shall be adopted at a meeting of the board of directors upon receiving a vote of a majority of the directors in office.

Section 40. Revocation of Voluntary Dissolution Proceedings

A corporation may, at any time prior to the issuance of a certificate of dissolution by the Secretary of State, revoke the action theretofore

taken to dissolve the corporation, in the following manner:

(a) If there are members entitled to vote thereon, the board of directors shall adopt a resolution recommending that the voluntary dissolution proceedings be revoked, and directing that the question of such revocation be submitted to a vote at a meeting of members entitled to vote thereon, which may be either an annual or a special meeting. Written notice stating that the purpose, or one of the purposes, of such meeting is to consider the advisability of revoking the voluntary dissolution proceedings, shall be given to each member entitled to vote at such meeting, within the time and in the manner provided in this Act for the giving of notice of meetings of members. A resolution to revoke the voluntary dissolution proceedings shall be adopted upon receiving at least two-thirds of the votes which members present at such meeting or represented by proxy are entitled to cast.

(b) If there are no members, or no members entitled to vote thereon, a resolution to revoke the voluntary dissolution proceedings shall be adopted at a meeting of the board of directors upon receiving the vote of a majority of the directors in office.

Upon the adoption of such resolution by the members, or by the board of directors where there are no members or no members entitled to vote thereon, the corporation may thereupon again conduct its affairs.

Section 41. Articles of Dissolution

If voluntary dissolution proceedings have not been revoked, then when all debts, liabilities and obligations of the corporation shall have been paid and discharged, or adequate provision shall have been made therefor, and all of the remaining property and assets of the corporation shall have been transferred, conveyed or distributed in accordance with the provisions of this Act, articles of dissolution shall be executed in duplicate by the corporation by its president or a vice president, and by its secretary or an assistant secretary, which statement shall set forth:

(a) The name of the corporation.

(b) If there are members entitled to vote thereon, (1) a statement setting forth the date of the meeting of members at which the resolution to dissolve was adopted, that a quorum was present at such meeting, and that such resolution received at least two-thirds of the votes which members present at such meeting or represented by proxy were entitled to cast, or (2) a statement that such resolution was adopted by a consent in writing signed by all members entitled to vote with respect thereto.

(c) If there are no members, or no members entitled to vote thereon, a statement of such fact, the date of the meeting of the board of directors at which the resolution to dissolve was adopted

and a statement of the fact that such resolution received the vote of a majority of the directors in office.

(d) That all debts, obligations, and liabilities of the corporation have been paid and discharged or that adequate provision has been made therefor.

(e) A copy of the plan of distribution, if any, as adopted by the corporation, or a statement that no plan was so adopted.

(f) That all the remaining property and assets of the corporation have been transferred, conveyed or distributed in accordance with the provisions of this Act.

(g) That there are no suits pending against the corporation in any court, or that adequate provision has been made for the satisfaction of any judgment, order or decree which may be entered against it in any pending suit.

Section 42. Filing of Articles of Dissolution

Duplicate originals of such articles of dissolution shall be delivered to the Secretary of State. If the Secretary of State finds that such articles of dissolution conform to law, he shall, when all fees have been paid as in this Act prescribed:

(1) Endorse on each of such duplicate originals the word "Filed," and the month, day and year of the filing thereof.

(2) File one of such duplicate originals in his office.

(3) Issue a certificate of dissolution to which he shall affix the other duplicate original.

The certificate of dissolution, together with the duplicate original of the articles of dissolution affixed thereto by the Secretary of State, shall be returned to the representative of the dissolved corporation. Upon the issuance of such certificate of dissolution the existence of the corporation shall cease, except for the purpose of suits, other proceedings and appropriate corporate action by members, directors and officers as provided in this Act.

Section 43. Approval of Superior Court

No action for voluntary dissolution shall be final until approved by the superior court in the county in which the corporation is located. A copy of the petition for dissolution must be submitted to the Secretary of State and the Attorney General, both of whom shall have the authority to participate in the proceedings before the court.

Section 44. Involuntary Dissolution

A corporation may be dissolved involuntarily by a decree of the superior court in an action filed by the Attorney General when it is established that:

(a) The corporation has failed to file its annual report within the time required by this Act; or

(b) The corporation procured its articles of incorporation through fraud; or

(c) The corporation has continued to exceed or abuse the authority conferred upon it by law; or

(d) The corporation has failed for ninety days to appoint and maintain a registered agent in this State; or

(e) The corporation has failed for ninety days after change of its registered agent to file in the office of the Secretary of State a statement of such change.

Section 45. Notification To Attorney General

The Secretary of State, on or before the last day of December of each year, shall certify to the Attorney General the names of all corporations which have failed to file their annual reports in accordance with the provisions of this Act. He shall also certify, from time to time, the names of all corporations which have given other cause for dissolution as provided in this Act, together with the facts pertinent thereto. Whenever the Secretary of State shall certify the name of a corporation to the Attorney General as having given any cause for dissolution, the Secretary of State shall concurrently mail to the corporation at its registered office a notice that such certification has been made. Upon the receipt of such certification, the Attorney General shall file an action in the name of the State against such corporation for its dissolution. Every such certificate from the Secretary of State to the Attorney General pertaining to the failure of a corporation to file an annual report shall be taken and received in all courts as prima facie evidence of the facts therein stated. If, before action is filed, the corporation shall file its annual report, or shall appoint or maintain a registered agent as provided in this Act, or shall file with the Secretary of State the required statement of change or registered agent, such fact shall be forthwith certified by the Secretary of State to the Attorney General and he shall not file an action against such corporation for such cause. If, after action is filed, the corporation shall file its annual report, or shall appoint or maintain a registered agent as provided in this Act, or shall file with the Secretary of State the required statement of change of registered agent, and shall pay the costs of such action, the action for such cause shall abate.

Section 46. Venue and Process

Every action for the involuntary dissolution of a corporation shall be commenced by the Attorney General in the superior court of the

county in which the registered office of the corporation is situated. Summons shall issue and be served as in other civil actions. If process is returned not found, the Attorney General shall cause publication to be made as in other civil cases in some newspaper published in the county where the registered office of the corporation is situated, containing a notice of the pendency of such action, the title of the court, the title of the action, and the date on or after which default may be entered. The Attorney General may include in one notice the names of any number of corporations against which actions are then pending in the same court. The Attorney General shall cause a copy of such notice to be mailed to the corporation at its registered office within ten days after the first publication thereof. The certificate of the Attorney General of the mailing of such notice shall be prima facie evidence thereof. Such notice shall be published at least once each week for two successive weeks, and the first publication thereof may begin at any time after the summons has been returned. Unless a corporation shall have been served with summons, no default shall be taken against it earlier than thirty days after the first publication of such notice.

Section 47. Jurisdiction of Court to Liquidate Assets and Affairs of Corporation

Courts of equity shall have full power to liquidate the assets and affairs of a corporation:

(a) In an action by a member or director when it is made to appear:

(1) That the directors are deadlocked in the management of the corporate affairs and that irreparable injury to the corporation is being suffered or is threatened by reason thereof, and either that the members are unable to break the deadlock or there are no members having voting rights; or

(2) That the acts of the directors or those in control of the corporation are illegal, oppressive or fraudulent; or

(3) That the members entitled to vote in the election of directors are deadlocked in voting power and have failed for at least two years to elect successors to directors whose terms have expired or would have expired upon the election of their successors;

(4) That the corporate assets are being misapplied or wasted; or

(5) That the corporation is unable to carry out its purposes.

(b) In an action by a creditor:

(1) When the claim of the creditor has been reduced to judgment and an execution thereon has been returned unsatisfied and it is established that the corporation is insolvent; or

(2) When the corporation has admitted in writing that the claim

of the creditor is due and owing and it is established that the corporation is insolvent.

(c) Upon application by a corporation to have its dissolution continued under the supervision of the court.

(d) When an action has been filed by the Attorney General to dissolve a corporation and it is established that liquidation of its affairs should precede the entry of a decree of dissolution.

Proceedings under this section shall be brought in the county in which the registered office or the principal office of the corporation is situated.

It shall not be necessary to make directors or members parties to any such action or proceedings unless relief is sought against them personally.

Section 48. Procedure In Liquidation of Corporation By Court

In proceedings to liquidate the assets and affairs of a corporation the court shall have the power to issue injunctions, to appoint a receiver or receivers pendente lite, with such powers and duties as the court, from time to time, may direct, and to take such other proceedings as may be requisite to preserve the corporate assets wherever situated, and carry on the affairs of the corporation until a full hearing can be had.

After a hearing had upon such notice as the court may direct to be given to all parties to the proceedings and to any other parties in interest designated by the court, the court may appoint a liquidating receiver or receivers with authority to collect the assets of the corporation. Such liquidating receiver or receivers shall have authority, subject to the order of the court, to sell, convey and dispose of all or any part of the assets of the corporation wherever situated, either at public or private sale. The order appointing such liquidating receiver or receivers shall state their powers and duties. Such powers and duties may be increased or diminished at any time during the proceedings.

The assets of the corporation or the proceeds resulting from a sale, conveyance, or other disposition thereof shall be applied and distributed as follows:

(a) All costs and expenses of the court proceedings and all liabilities and obligations of the corporation shall be paid, satisfied and discharged, or adequate provision shall be made therefor;

(b) Assets held by the corporation upon condition requiring return, transfer or conveyance, which condition occurs by reason of the dissolution or liquidation, shall be returned, transferred or conveyed in accordance with such requirements;

(c) Assets received and held by the corporation subject to limita-

tions permitting their use only for charitable, religious, eleemosynary, benevolent, educational or similar purposes, but not held upon a condition requiring return, transfer or conveyance by reason of the dissolution or liquidation, shall be transferred or conveyed to one or more domestic or foreign corporations, societies or organizations engaged in activities substantially similar to those of the dissolving or liquidating corporation as the court may direct;

(d) Other assets, if any, shall be distributed in accordance with the provisions of the articles of incorporation or the by-laws to the extent that the articles of incorporation or by-laws determine the distributive right of members, or any class or classes of members, or provide for distribution to others;

(e) Any remaining assets may be distributed to such persons, societies, organizations or domestic or foreign corporations, whether for profit or not for profit, specified in the plan of distribution adopted as provided in this Act, or where no plan of distribution has been adopted, as the court may direct.

The court shall have power to allow, from time to time, as expenses of the liquidation compensation to the receiver or receivers and to attorneys in the proceeding, and to direct the payment thereof out of the assets of the corporation or the proceeds of any sale or disposition of such assets.

A receiver of a corporation appointed under the provisions of this section shall have authority to sue and defend in all courts in his own name as receiver of such corporation. The court appointing such receiver shall have exclusive jurisdiction of the corporation and its property, wherever situated.

Section 49. qualification of Receivers

A receiver shall in all cases be a citizen of the United States or a corporation for profit authorized to act as receiver, which corporation may be a domestic corporation or a foreign corporation authorized to transact business in this State, and shall in all cases give such bond as the court may direct with such sureties as the court may require.

Section 50. Filing Of Claims In Liquidation Proceedings

In proceedings to liquidate the assets and affairs of a corporation the court may require all creditors of the corporation to file with the clerk of the court or with the receiver, in such form as the court may prescribe, proofs under oath of their respective claims. If the court requires the filing of claims it shall fix a date, which shall be not less than four months from the date of the order, as the last day for the filing of claims, and shall prescribe the notice that shall

be given to creditors and claimants of the date so fixed. Prior to the date so fixed, the court may extend the time for the filing of claims. Creditors and claimants failing to file proofs of claim on or before the date so fixed may be barred, by order of court, from participating in the distribution of the assets of the corporation.

Section 51. Discontinuance Of Liquidation Proceedings

The liquidation of the assets and affairs of a corporation may be discontinued at any time during the liquidation proceedings when it is established that cause for liquidation no longer exists. In such event the court shall dismiss the proceedings and direct the receiver to redeliver to the corporation all its remaining property and assets.

Section 52. Decree Of Involuntary Dissolution

In proceedings to liquidate the assets and affairs of a corporation, when the costs and expenses of such proceedings and all debts, obligations, and liabilities of the corporation shall have been paid and discharged and all of its remaining property and assets distributed in accordance with the provisions of this Act, or in case its property and assets are not sufficient to satisfy and discharge such costs, expenses, debts, and obligations, and all the property and assets have been applied so far as they will go to their payment, the court shall enter a decree dissolving the corporation, whereupon the existence of the corporation shall cease.

Section 53. Survival Of Remedy After Dissolution

The dissolution of a corporation either (1) by the issuance of a certificate of dissolution by the Secretary of State, or (2) by a decree of court when the court has not liquidated the assets and affairs of the corporation as provided in this Act, or (3) by expiration of its period of duration, shall not take away or impair any remedy available to or against such corporation, its directors, officers, or members, for any right or claim existing, or any liability incurred, prior to such dissolution if action or other proceeding thereon is commenced within two years after the date of such dissolution. Any such action or proceeding by or against the corporation may be prosecuted or defended by the corporation in its corporate name. The members, directors and officers shall have power to take such corporate or other action as shall be appropriate to protect such remedy, right or claim. If such corporation was dissolved by the expiration of its period of duration, such corporation may amend its articles of incorporation at any time during such period of two years so as to extend its period of duration.

SECTION 54. ANNUAL REPORT

An annual report accompanied by a filing fee of one dollar [$1.00] shall be filed with the secretary of state by all nonprofit corporations, domestic or foreign, whether incorporated under this or any other law. However, if a corporation is incorporated under a law of this state, which provides that it shall file annual reports with the secretary of state, this section shall not apply to it. The fee shall be in lieu of all other annual fees to be paid by the corporation. The report shall be filed in the month of February; however, any corporation which operates on a fiscal year basis, which is other than a calendar year, may file the report during the second calendar month following the end of the fiscal year, but shall first notify the secretary of state, on forms provided by the secretary of state, of the period of its fiscal year. Such report shall contain the following information as of the last day of the preceding calendar or fiscal year:

(a) The name of the corporation.

(b) The location and post office address of its principal office in this state and the name and address of the resident agent or of some designated person residing in this state upon whom service of process may be served.

(c) The date of incorporation, and, if a foreign corporation, the date when admitted and qualified in this state as a foreign corporation.

(d) The law under which it was incorporated.

(e) The names and residence addresses of officers and directors and the number of existing members.

(f) The purposes of the corporation.

(g) A totalled itemized account of all outstanding debts, including the names of persons or corporations to whom sums are owing, the original amount of the debt incurred, the method of making payment, and from what funds the debt is to be paid. If any member, any relative of a member, or any person having a contract or agreement concerning the subject matter of the debt has any interest or opportunity to profit from the transaction, an explanation must be filed together with copies of any written agreements connected with the subject matter of the indebtedness.

(h) A list of all property, real and personal, owned by the corporation, itemized to the extent required by the secretary of state, and its current market value set opposite each respective item, Provided that the list of all real property also includes the price paid for it by the corporation, a legal description, the acreage or size of each tract or lot, and the assessed value of each tract or lot.

(i) The nature and kind of activities in which the corporation has been engaged during the year covered by the report.

(j) What, if any, distribution of funds has been made to any members during the year covered by the report.

(k) A statement of the aggregate amount of any loans, advances, overdrafts or withdrawals and repayments made to or by any officers, directors or members.

(l) A verified itemized statement of revenue received by the corporation from all sources during the preceding calendar year, clearly stating the sources of the revenue in each instance, together with a general statement showing total disbursement and all cash and assets. No trust fund shall be included as an asset of the corporation, but must be separately listed and identified. Said reports shall be prepared and filed in and on forms prescribed and furnished by the secretary of state. If, upon receipt of such report, the secretary of state, after reviewing it, determines or has reason to believe that the corporation filing the report is not disclosing its true financial condition or is violating any of the provisions of this chapter or the nonprofit corporation law in general, he may require the corporation to disclose all material facts by submitting a duly verified audit bearing the certificate under oath of a qualified public accountant recognized by the secretary of state, replying to interrogatories and/or reporting under oath on any matters requested by the secretary of state.

The board will cause an annual report to be sent to the members not later than 120 days after the close of the corporation's fiscal year. This requirement need not be complied with if:

(1) The corporation is a public benefit corporation and has fewer than 100 members or ten thousand dollars ($10,000) in assets at any time during the fiscal year.

(2) The corporation is a general purpose corporation. Not-withstanding the foregoing a copy of the annual report shall be furnished to:

(1) All directors of the corporation; and

(2) Any member who requests it in writing.

Public benefit corporations shall place an advertisement in a newspaper of general circulation in the county in which the corporation's principal place of business is located informing readers that their annual reports have been filed with the Secretary of State. The advertisement must appear within 120 days after the close of the corporation's fiscal year.

Public benefit corporations must place at least three (3) copies of their annual reports in the public library in the county in which their principal place of business is located.

Section 55. Merger Or Consolidation—Authority

Any one or more nonprofit corporations which are organized or reorganized under the provisions of this chapter may merge or consol-

idate with one or more other not-for-profit corporations organized under the laws of this state or any other state or states of the United States of America, if the laws under which the other corporation or corporations are formed, shall permit the merger or consolidation. The constituent corporations may merge into a single corporation, which may be any one (1) of the constituent corporations, or they may consolidate to form a new corporation, which may be a corporation of the state of incorporation of any one (1) of such constituent corporations as shall be specified in the agreement hereinafter required.

Section 56. Merger of Domestic Corporation

Any two (2) or more domestic corporations may merge into another domestic corporation in the following manner:

(a) Agreement of Merger. The board of directors of each corporation shall, by a resolution adopted by a majority vote of the members of the board, approve a joint agreement of merger setting forth:

(1) The names of the corporations proposing to merge, and the name of the corporation into which they propose to merge, which is hereinafter designated as the surviving corporation.

(2) The terms and conditions of the proposed merger and the mode of carrying them into effect.

(3) A restatement of the provisions of the articles of incorporation of the surviving corporation as may be deemed necessary or advisable to give effect to the proposed merger.

(4) Any other provisions with respect to the proposed merger which are deemed necessary or desirable.

The resolution of the board of directors of each corporation approving the agreement shall direct that the agreement be submitted to a vote of the members of the corporation, who are entitled to vote in respect to the proposal for merger, at a designated meeting, which may be an annual meeting or a special meeting of those members entitled to vote. If the designated meeting at which the agreement is to be submitted is an annual meeting, notice of the submission of the agreement shall be included in the notice of the annual meeting. If the designated meeting is a special meeting, it shall be called by the resolution designating the meeting, and notice of this meeting shall be given at the time and in the manner provided in section 9 of this chapter.

(b) Adoption of Agreement. The agreement of merger so approved shall be submitted to a vote of the members of each corporation entitled to vote on the agreement, at the meeting directed by the resolution of the board of directors of the corporation approving the agreement, and the agreement shall be adopted by the corporation upon receiving the affirmative votes of those members who are entitled to vote in respect thereof. If the members of any class of

members are entitled to vote as a class, the proposal shall be adopted upon receiving the affirmative vote of a majority of the members of such class, and of the total shares entitled to vote.

Notwithstanding the requirements of this subsection, unless required by its articles of incorporation with respect to corporations having more than one hundred (100) members, no vote of the members of the surviving corporation shall be required to adopt an agreement of merger if the agreement of merger does not amend the articles of incorporation of the surviving corporation or contain any provision which, if contained in a proposed amendment to the articles of incorporation, would entitle the members of any class to vote as a class. If an agreement of merger is adopted by the surviving corporation through action of its board of directors and without any vote of its members, pursuant to this paragraph, then that shall be so stated in the articles of merger required to be filed with the secretary of state by the dictates of this section.

(c) Members Entitled to Vote. The members of any corporation entitled to vote in respect to an agreement of merger of the corporation, shall be the members who, by the terms of the articles of incorporation of the corporation, are entitled to vote upon questions of merger. Any class of members of any corporation shall be entitled to vote as a class if the agreement of merger contains any provision which, if contained in a proposed amendment to articles of incorporation, would entitle the class to vote as a class.

(d) Notice to Members. Within five (5) days after an agreement of merger is adopted by any corporation, the secretary of such corporation shall deliver or mail a written or printed notice of the adoption of the agreement to each member of record of the corporation, who was not present in person or represented by proxy at the meeting at which the agreement was adopted.

(e) Reapproval by Directors and Execution of Agreement. As soon as practicable after the expiration of a period of thirty (30) days from the adoption of the agreement of merger by the members of the merger corporation which is the last, in point of time, to adopt the merger, the agreement shall again be considered by the board of directors of each participating corporation at a regular or special meeting of the board, and if the board of directors of each corporation, by a majority vote, shall again approve the agreement and authorize its execution, the agreement shall be signed on behalf of each corporation by any current officer of the corporation and verified and affirmed subject to penalties for perjury. However, in the event that the members of the corporation vote unanimously in favor of the adoption of the agreement of merger, a reapproval of the agreement by the board of directors of each corporation shall not be required. The board of directors of any of the corporations, by appropriate

resolutions adopted at any time, may authorize the execution and consummation of the agreement of merger at such time as the procedures required by the section have been complied with.

The articles of merger shall be signed on behalf of each corporation by any current officer of the corporation and verified and affirmed subject to penalties for perjury, and shall then be presented to the secretary of state at his office, accompanied by those fees prescribed by law.

(f) Articles of Merger. Upon the execution of the agreement of merger by all of the corporations parties thereto, there shall be executed and filed, in the manner hereinafter provided, articles of merger setting forth the agreement of merger, the signatures of those authorized to sign for the merging corporations, the manner of its adoption and the vote by which it was adopted by each of the corporations.

(g) Certificate of Merger. Upon the presentation of the articles of merger, the secretary of state, if he finds that they conform to law, shall indorse his approval upon both of the duplicate copies of the articles, and, when all fees have been paid as required by law, shall file one (1) copy of the articles in his office, issue a certificate of merger, and shall return the remaining copy of the articles, bearing the indorsement of his approval, together with the certificate of merger, to the surviving corporation.

Section 57. Consolidation of Domestic Corporation

Any two (2) or more domestic corporations may consolidate into a new corporation organized under this chapter in the following manner:

(a) Agreement of Consolidation. The board of directors of each corporation shall by a resolution adopted by a majority vote of the members of the board, approve a joint agreement of consolidation setting forth:

(1) The names of the corporations proposing to consolidate, and the name of the resultant new corporation, which is hereinafter designated as the new corporation;

(2) The terms and conditions of the proposed consolidation and the mode of carrying it into effect;

(3) With respect to the new corporation, all of the statements required by section 18 of this chapter to be set forth in original articles of incorporation for corporations formed under this chapter; and

(4) Any other provisions with respect to the proposed consolidation which are deemed necessary or desirable.

(b) In all respects other than set forth in this section, the provisions for merger in section 42 of this chapter shall be complied with the same as if the proposed consolidation was to be a merger.

(c) Articles of Consolidation. Upon the execution of the agree-

ment of consolidation by all of the participating corporations, articles of consolidation shall be executed and presented to the secretary of state at his office, in duplicate, accompanied by the fees prescribed by law, in the same manner and form as prescribed above in subsection (f) of section 42 of this chapter for a merger.

(d) Certificate of Consolidation and Incorporation. Upon the presentation of the articles of consolidation, the secretary of state, if he finds they conform to law, shall indorse his approval upon both of the duplicate copies of the articles, and, when all fees have been paid as required by law, shall file one (1) copy of the articles in his office, issue a certificate of consolidation and incorporation to the new corporation and shall return to the new corporation or its designated agent, the remaining copy of the articles of consolidation, bearing the indorsement of his approval, together with the certificate of consolidation and incorporation.

Section 58. Mergers and Consolidations

Author's Note: This section, and subsequent sections, would cover the merger or consolidation between domestic and foreign corporations, the merger of foreign corporations admitted to transact business in Indiana, the effective date of merger or consolidation and the effect of mergers and consolidations.

One or more foreign corporations and one or more domestic corporations may be merged or consolidated in the following manner, if a merger or consolidation is permitted by the laws of the state under which each such foreign corporation is organized:

(a) Each domestic corporation shall comply with the provisions of this chapter with respect to a merger or consolidation of domestic corporations and each foreign corporation shall comply with those applicable provisions of the laws of the state under which it is organized.

(b) If the surviving or new corporation is to be governed by the laws of any state other than this state, it shall comply with the provisions of this chapter for foreign corporations if it is to transact business in this state, and in every case it shall file with the secretary of state;

(1) An agreement that it may be served with process in this state in any proceeding for the enforcement of any obligation of any domestic corporation which is a party to the merger or consolidation and in any proceeding for the enforcement of the rights of a dissenting member of any domestic corporation against the surviving or new corporation;

(2) An irrevocable appointment of the secretary of state as its agent to accept service of process in any proceeding together with the

address to which a copy of such process should be mailed by the secretary of state.

The effect of the merger or consolidation shall be the same as that of a merger or consolidation of domestic corporations, if the surviving or new corporation is to be governed by the laws of this state. If the surviving or new corporation is to be governed by the laws of any state other than this state, the effect of the merger or consolidation shall be the same as that of the merger or consolidation of domestic corporations except when the laws of the other state provide otherwise. The surviving or new corporation shall file for record duplicates of the certificate of merger or consolidation, duly certified by the secretary of state under the seal of his office, as provided in section 28(c) of this chapter. If the surviving or new corporation is to be governed by the laws of any state other than this state, within thirty (30) days after the effective date of the merger or consolidation, it shall file with the secretary of state a duplicate of the certificate of merger or consolidation issued by its state of incorporation, duly certified by the officer of the state having custody thereof.

Section 59. Merger or Consolidation of Domestic and Foreign Corporations

One or more foreign corporations and one or more domestic corporations may be merged or consolidated in the following manner, if a merger or consolidation is permitted by the laws of the state under which each such foreign corporation is organized:

(a) Each domestic corporation shall comply with the provisions of this chapter with respect to a merger or consolidation of domestic corporations and each foreign corporation shall comply with those applicable provisions of the laws of the state under which it is organized.

(b) If the surviving or new corporation is to be governed by the laws of any state other than this state, it shall comply with the provisions of this chapter for foreign corporations if it is to transact business in this state, and in every case it shall file with the secretary of state;

(1) An agreement that it may be served with process in this state in any proceeding for the enforcement of any obligation of any domestic corporation which is a party to the merger or consolidation and in any proceeding for the enforcement of the rights of a dissenting member of any domestic corporation against the surviving or new corporation;

(2) An irrevocable appointment of the secretary of state as its agent to accept service of process in any proceeding together with the

address to which a copy of such process should be mailed by the secretary of state.

The effect of the merger or consolidation shall be the same as that of a merger or consolidation of domestic corporations, if the surviving or new corporation is to be governed by the laws of this state. If the surviving or new corporation is to be governed by the laws of any state other than this state, the effect of the merger or consolidation shall be the same as that of the merger or consolidation of domestic corporations except when the laws of the other state provide otherwise. The surviving or new corporation shall file for record duplicates of the certificate of merger or consolidation, duly certified by the secretary of state under the seal of his office, as provided in section 30 of this chapter. If the surviving or new corporation is to be governed by the laws of any state other than this state, within thirty (30) days after the effective date of the merger or consolidation, it shall file with the secretary of state a duplicate of the certificate of merger or consolidation issued by its state of incorporation, duly certified by the officer of the state having custody thereof.

Section 60. Foreign Corporations-Admission

Any foreign corporation organized without capital stock and as a nonprofit corporation, not now qualifed to transact business in this state, shall procure a certificate of admission from the secretary of state before transacting business in this state in the manner hereinafter provided and shall otherwise comply with the provisions and be subject to the regulations set forth in this chapter.

Section 61. Foreign Corporations-Powers

No foreign corporation shall be admitted for the purpose of transacting any kind of business in this state which domestic corporations are not permitted to transact by the laws of this state. A foreign corporation admitted to do business in this state shall have the same, but no greater, rights and privileges, and be subject to the same liabilities, restrictions, duties and penalties, now in force or hereafter imposed upon domestic corporations of like character, and to the same extent as if it had been organized under this chapter to transact the business for which its certificate of admission is issued.

Section 62. Foreign Corporations-Corporate Name

No foreign corporation shall be admitted to do business in this state having a name which, at the date of such admission, could not be taken by a domestic corporation under the provisions of section 5 of this chapter, except that the name of a foreign corporation need not

include the word "corporation" or "incorporated" or one of the abbreviations thereof; and no such foreign corporations after it has been admitted shall, by amendment to its charter, assume any name which, at the date of the filing of such amendment as hereinafter provided, could not be taken by a domestic corporation, under the provisions of said section 5 of this chapter.

Section 63. Foreign Corporation-Application for Admission

Whenever a foreign corporation desires to be admitted to do business in this state, it shall present to the secretary of state at his office accompanied by the fees prescribed by law:

(1) a copy of its articles of incorporation or association, with all amendments thereto, duly authenticated by the proper officer of the state or country wherein it is incorporated; and

(2) an application for admission, executed in the manner hereinafter provided, setting forth:

(a) The name of such corporation.

(b) The location of its principal office or place of business without this state, and the location of the proposed principal office or place of business within this state.

(c) The names of the states in which it has been admitted or qualified to do business.

(d) The character of business under its articles of incorporation or association which it intends to carry on in this state.

(e) The names and post-office addresses of its officers and directors.

(f) The name and post-office address of some person permanently residing in this state, upon whom, as the resident agent of the corporation until his successor shall have been appointed, service of legal process may be had.

(g) If the memberships are divided into classes the designations of the different classes, and a statement of the relative rights, preferences, limitations and restrictions of each class, together with a statement as to the voting rights of any such class.

(h) A statement of property in Indiana and an estimate of the value thereof, to be taken over by this corporation upon its admittance to Indiana.

(i) Any other provisions, consistent with the laws of the state of Indiana for the regulation and conduct of the affairs of the corporation, and creating, defining, limiting or regulating the powers of the corporation, of the directors or of the members or any class or classes of members.

(j) Such further information as the secretary of state may require which shall include a statement of assets and liabilities as of the

last day of the last calendar month preceding the submission of the application for admission.

The application shall be signed in duplicate in the form prescribed by the secretary of state, by any current officer of the corporation and verified and affirmed subject to penalties for perjury.

The secretary of state shall have power and authority to interrogate all foreign corporations, and the officers and agents thereof, applying for admission in this state, with respect to the character of business in which such corporations proposed to engage in Indiana, and with respect to any other matters required to be stated in applications for admission; and such interrogatories shall be answered under oath. Such interrogatories and answers shall be filed with the respective applications to which they pertain, and shall operate as a limitation upon the authority of such corporations to transact business in this state.

Section 64. Foreign Corporations-Certificate of Admission

Upon the presentation of the application of admission, the secretary of state, if he finds that it conforms to law, shall indorse his approval upon each of the duplicate copies, and, when all fees required by law shall have been paid, shall file one (1) copy of the application, together with the authenticated copy of the articles of incorporation or association of the corporation, in his office, and shall issue to the corporation a certificate of admission, accompanied by one (1) copy of the application bearing the indorsement of his approval, which certificate shall set forth:

(1) The name of the corporation, the state or country where it was incorporated and the location of its principal office in such state or country;

(2) The character of business it is authorized to transact in this state;

(3) The amount of the fee paid for its admission;

(4) The address of the corporation in this state, and;

(5) The name and address of its resident agent in this state for the service of legal process.

Upon the issuance of a certificate of admission by the secretary of state, the corporation therein named shall be admitted, and shall have authority to transact in this state, the business set forth in such certificate, subject to terms and conditions prescribed by this chapter.

Section 65. Resident Agent for Service of Process

(a) Each foreign corporation admitted to do business in this state shall constantly keep on file in the office of the secretary of state a certificate of any current officer of the corporation, verified and affirmed subject to penalties for perjury, setting forth the location of

its principal office in this state and the name of its agent or representative at that office on whom service of legal process may be had in all suits and actions that may be commenced against it. For the purposes of this section, the application for admission filed by a foreign corporation is such a certificate. Whenever a corporation changes the location of its principal office in this state or changes its agent for service of legal process or such agent shall be removed by death, resignation, or incapacity, the officers of the corporation shall immediately file a new certificate with the secretary of state.

(b) If the resident agent for one (1) or more corporations changes address, the agent may change the address on file with the secretary of state by filing in the office of the secretary of state a statement setting forth:

(1) the names of the corporations for which the change is effective;

(2) the old and new addresses of the resident agent; and

(3) the date on which the change is effective.

If the old and new addresses of the resident agent are the same as the old and new addresses of the principal office of the corporations, the statement may include a change of address of the principal office of the corporations.

(c) A resident agent who files a statement under subsection (b) shall first notify in writing each corporation for which the agent is resident agent that the statement will be filed, and the statement must recite the fact that this notice has been given. The statement shall be executed and verified in duplicate and affirmed subject to penalties of perjury by the resident agent in his individual name; however, if the resident agent is a foreign or domestic corporation, the statement must be executed by a current officer of the corporation. The statement, executed in duplicate, shall be delivered to the secretary of state. If he finds that it conforms to the requirements of law, the secretary of state shall, upon payment of the required fees, endorse upon each of the duplicates tendered for filing, over his signature and official seal, the word "filed" followed by the date of the filing. The secretary of state shall retain one (1) executed copy of the statement in his files. He shall attach to the other filed copy a certificate stating that the instrument is an executed copy of the statement filed in his office, giving the date of the filing, and shall return the other copy to the resident agent.

(d) Any person who has been designated as resident agent for service of process by a foreign corporation may file with the secretary of state a signed statement that he is unwilling to continue to act as resident agent for the corporation. Upon the filing of such statement with the secretary of state, the capacity of the person as resident agent terminates and the secretary of state shall give written notice by mail to the foreign corporation of the filing of the state-

ment and its effect. The notice shall be addressed to the corporation at its principal office or place of business as shown by the records of his office.

(e) If and when any foreign corporation admitted to do business in this state shall not have available in this state its agent or representative on whom service of legal process may be made, service may be made upon the secretary of state, accompanied by a fee of five dollars ($5), and the secretary of state shall mail such process by registered mail with return receipt requested to the post office address of the corporation in the state in which the corporation is incorporated as shown by its last annual report to the secretary of state. The returned receipt shall be filed with the court in which the action is pending and shall be considered sufficient service upon the nonresident corporation. In the event that the corporation refuses to accept or claim the registered mail, the registered mail shall be returned by the secretary of state to the plaintiff or his attorney, and it shall be appended to the original process, together with an affidavit of the plaintiff or of his attorney or agent to the effect that the summons was delivered to the secretary of state, and thereafter returned unclaimed by the post office department, and such affidavit, together with the returned envelope including the summons, shall be considered sufficient service upon the nonresident corporation. Any legal process served upon the secretary of state as herein provided shall not be returnable in less than thirty (30) days from the date on which the service is made upon the secretary of state. The court in which the action is brought may order such continuances as may be reasonable to afford the corporation opportunity to defend the action.

Section 66. Amendments to Charter

Each foreign corporation admitted to do business in this state shall keep on file in the office of the secretary of state a duly authenticated copy of each instrument amending its articles of incorporation or association; but the filing of any such instrument shall not of itself enlarge or alter the character of business which the foreign corporation is authorized to transact in this state as set forth in the certificate of admission, nor authorize such corporation to transact business in this state under any other name than the name set forth in its certificate of admission unless such foreign corporation shall apply for and receive an amended certificate of admission as provided in the next succeeding section.

Section 67. Amended Certificate

Any foreign corporation admitted to do business in this state may alter or enlarge the character of business which it is authorized to

transact in this state under its articles of incorporation or association, and any amendments thereof filed with the secretary of state as hereinabove provided, and may obtain authority to transact business in this state under a different name than the name set forth in its certificate of admission, by procuring an amended certificate of admission from the secretary of state in the manner hereinafter provided.

Whenever a foreign corporation desires to procure an amended certificate, it shall present to the secretary of state at his office, accompanied by the fees prescribed by law, an application for an amended certificate of admission, stating the change desired in the character of business under its articles of incorporation or association and the name under which it desires to transact business. The application shall be signed in duplicate, in the form prescribed by the secretary of state, by any current officer of the corporation and verified and affirmed subject to penalties for perjury.

Upon the presentation of such application, the secretary of state, if he finds that it conforms to law, shall indorse his approval upon each of the duplicate copies and shall file one (1) copy of the application in his office and issue to the corporation an amended certificate of admission, accompanied by one (1) copy of the application bearing the indorsement of his approval. The certificate shall set forth the character of business that the corporation is authorized thereafter to transact in this state.

Upon the issuance of an amended certificate of admission by the secretary of state, the corporation shall have authority to transact the business set forth in the certificate, subject to the terms and conditions prescribed by this chapter.

If amended certificate of admission authorizes the corporation to transact business in this state under a new corporate name, the corporation shall, within ten (10) days after the issuance of any such amended certificate, file for record a duplicate amended certificate fo admission, duly certified by the secretary of state under the seal of his office, with the county recorder of each county in this state in which it shall have real property at the time such amended certificate is issued.

Section 68. Withdrawal From State

Any foreign corporation admitted to do business in this state may withdraw from this state by surrendering its certificate of admission, and any amended certificates of admission that may have been issued to it, and by filing with the secretary of state, accompanied by the fees prescribed by law, a statement of withdrawal setting forth:

(1) The name of the corporation and the state or country in which it was incorporated.

(2) The date of the issuance of its certificate of admission, and of each amended certificate of admission, if any.

(3) That it is no longer operating in this state and that it has no property located in this state.

(4) That it surrenders its authority to transact business in this state and returns for cancellation its certificate of admission and any amended certificate of admission issued to it.

(5) That it revokes the authority of its then named resident agent to accept service of legal process; and that it consents that process against it thereafter may be had upon the corporation, in any action or proceeding upon any liability or obligation incurred within this state before the filing of the statement of withdrawal, by serving the secretary of state.

(6) A post-office address to which the secretary of state may mail a copy of any process against it that may be served upon him.

Such statement shall be signed, in the form prescribed by the secretary of state, by any current officer of the corporation and verified and affirmed subject to penalties for perjury.

Upon the filing of such statement, accompanied by the certificate of admission and any amended certificates of admission issued to the corporation, the authority of the corporation to transact business in this state shall cease; but the filing of such statement shall not affect any action by or against such corporation pending at the time thereof or any right of action existing at or before the filing of such statement in favor of or against such corporation.

Section 69. Revocation of Certificate

The certificate of admission of any foreign corporation admitted to do business in this state may be revoked at any time by the secretary of state:

(1) upon the failure of an officer or director to whom interrogatories are propounded by the secretary of state to answer fully and to file such answers in the office of the secretary of state within thirty (30) days after the mailing of the interrogatories by the secretary of state;

(2) upon the existence in this state of the corporation for thirty (30) days without appointing and maintaining an agent in this state upon whom service of legal process may be had;

(3) upon the existence in this state of the corporation for thirty (30) days without keeping on file in the office of the secretary of state duly authenticated copies of each instrument amending its charter;

(4) upon the failure, neglect or refusal of the corporation to pay within thirty (30) days any fee required by the laws of this state; or

(5) for wilful misrepresentation of any material matter in any application, statement, affidavit, or other paper, filed by such corporation pursuant to this chapter.

No certificate of authority of a foreign corporation shall be revoked by the secretary of state unless he shall have given the corporation not less than sixty (60) days' notice thereof by first class mail addressed to its resident agent at his address in this state or, if there is no resident agent, to the principal office of the corporation outside this state.

Upon revoking any such certificate of admission, the secretary of state shall (1) issue duplicate copies of a certificate or revocation, (2) file one (1) copy in his office, and (3) mail to the corporation at its principal office outside this state by registered or certified mail a notice of such revocation, accompanied by one (1) of the copies of the certificate of revocation.

Upon the revocation by the secretary of state, the authority of the corporation to transact business in this state shall cease, and such corporation shall not thereafter transact any business in this state unless it applies for and receives a new certificate of admission.

Section 70. Application to Corporations Now Qualified

Foreign corporations entitled to transact business in this state, as not-for-profit corporations, at the time this chapter becomes effective shall be entitled to all of the rights and privileges, and shall be subject to all the limitations, restrictions, liabilities and duties, prescribed herein for foreign corporations admitted to transact business in this state under this chapter.

Section 71. Service of Process After Withdrawal or Revocation

Whenever the certificate of admission of any foreign corporation shall be withdrawn or revoked, then, in any suit or proceeding thereafter commenced against it for or on account of any obligation or liability growing out of any business theretofore or thereafter done by it in this state, service of legal process may be had by serving such process upon the secretary of state upon the same terms and provisions as provided for by section 53 of this chapter in the case of service of legal process on a foreign corporation which is admitted to do business but does not have a resident agent in this state.

Section 72. Transaction of Business Without Certificate of Admission; Maintenance of Suits; Penalty

(a) No foreign corporation transacting business in this state without procuring a certificate of admission or, if such a certificate has been

procured, after its certificate of admission has been withdrawn or revoked, may maintain any suit, action or proceeding in any of the courts of this state upon any demand, whether arising out of contract or tort; and every such corporation so transacting business is liable by reason thereof to a penalty of not exceeding ten thousand dollars ($10,000), to be recovered in an action to be begun and prosecuted by the attorney general in any county in which such business was transacted.

(b) If any foreign corporation transacts business in this state without procuring a certificate of admission, or, if a certificate has been procured, after its certificate has been withdrawn or revoked, or transacts any business not authorized by the certificate, the corporation is not entitled to maintain any suit or action at law or in equity upon any claim, legal or equitable, whether arising out of contract or tort, in any court in this state; and the attorney general, upon being advised that any foreign corporation is so transacting business in this state, shall bring an action in the circuit or superior court of Marion County for an injunction to restrain it from transacting such unauthorized business and for the annulment of its certificate of admission, if one has been procured.

(c) An agent of any foreign corporation who transacts for the corporation any business in Indiana before it has procured a certificate of admission or after its certificate has been withdrawn or revoked commits a Class C infraction.

Democracy and Distemper: An Examination of the Sources of Judicial Distress in State Legislative Apportionment Cases

DANIEL DOVENBARGER*

I. INTRODUCTION

A. Troublesome Thickets — Old or New?

When the United States Supreme Court in *Baker v. Carr*[1] led the courts of America down the path permitting judicial review of apportionment legislation, there were repeated warnings that the Court would ensnare itself in a "political thicket."[2] When the Court later decided *Wesberry v. Sanders*[3] and *Reynolds v. Sims,*[4] however, it encountered no thicket blocking progress toward its commitment to equality of voting powers. Even now it is not at all clear what of this feared "thicket" was supposed to be.[5]

In part, Justice Harlan's criticism of the Court's decision in *Baker*

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[1]369 U.S. 186 (1962). The Court in *Baker* reversed a lower court dismissal of a suit challenging Tennessee's state legislative apportionment as violating the equal protection clause. The Court held that federal courts had jurisdiction over the question, that the controversy was justiciable, and that federal courts possessed equitable powers sufficient to award relief.

[2]The imagery of a "political thicket" first appeared in Justice Frankfurter's opinion for the Court in Colegrove v. Green, 328 U.S. 549, 556 (1946), where the court held there was insufficient equitable power to make justiciable the claim that Illinois' congressional districts violated the equal protection clause. The imagery reappeared in Justice Harlan's dissent in Baker v. Carr, 369 U.S. at 330. In *Reynolds* itself, the opinion of Chief Justice Warren cautioned against "the dangers of entering into political thickets and mathematical quagmires." Reynolds v. Sims, 377 U.S. 533, 566 (1964).

[3]376 U.S. 1 (1964).

[4]377 U.S. 533 (1964). In addition to *Reynolds*, the court released five other state legislative apportionment cases on the same day: Lucas v. Forty-Fourth General Assembly of Colorado, 377 U.S. 713 (1964); Roman v. Sincock, 377 U.S. 695 (1964); Davis v. Mann, 377 U.S. 678 (1964); Maryland Committee for Fair Representation v. Tawes, 377 U.S. 656 (1964); WMCA, Inc. v. Lomenzo, 377 U.S. 633 (1964). Within two weeks the court had invalidated eight other state legislative apportionment plans. *See* Hill v. Davis, 378 U.S. 565 (1964); Pinney v. Butterworth, 378 U.S. 564 (1964); Hearne v. Smylie, 378 U.S. 563 (1964); Marshall v. Hare, 378 U.S. 561 (1964); Germano v. Kerner, 378 U.S. 560 (1964); Williams v. Moss, 378 U.S. 558 (1964); Nolan v. Rhodes, 378 U.S. 556 (1964)(per curiam); Meyers v. Thigpen, 378 U.S. 544 (1964)(per curiam); Swann v. Adams, 378 U.S. 533 (1964).

[5]J. ELY, DEMOCRACY AND DISTRUST: A THEORY OF JUDICIAL REVIEW 120 (1980).

to permit review of apportionment stemmed from institutional concerns.[6] He worried about the public perception of the Court's involvement in the apportionment process.[7] The benefit of hindsight, however, makes his worries seem somewhat trivial[8] because the Court's commitment to equality probably enhanced its standing in the eyes of the public.[9] Either the keen edge of the slogan "one person, one vote"[10] had cleared the thicket feared by the dissenters in *Baker* or the thicket had never really existed.

Twenty years after the Court decided *Reynolds*, an examination of state legislative apportionment cases and literature uncovers a confusing array of rules and obligations that have been imposed upon apportioning bodies.[11] The growth of tests and rules governing apportionment belies the simplicity and elegance of the original *Reynolds* formulation of "one person, one vote." The journey from simplicity to complexity has created confusion which distresses legislatures, courts, and observers.[12] In short, the Court may have gradually created its own "thicket" in state legislative apportionment cases. For those committed to equality, this newly visible "thicket" presents an obstacle to the goal of equal voting power announced in *Reynolds*.[13]

Close examination of this emerging thicket indicates that it is neither ancient nor political. Instead, it is of the Court's own making. Furthermore, while the thicket may have sprung from seeds originally sown in *Reynolds*, it is more certainly the cultivated product of the intellectual and ideological eclecticism of the Burger Court.[14] Harmless dicta of the

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[6]Baker v. Carr, 369 U.S. at 340 (Harlan, J., dissenting).

[7]*Id.*

[8]ELY, *supra* note 5, at 121.

[9]*Id.* There were sustained efforts of Senator Dirksen to pass a constitutional amendment overturning the Court's decision in *Reynolds*, but these efforts failed. *See* 111 CONG. REC. 19,373 (1965) (vote for Dirksen Amendment fails by eleven votes in 1965); 112 CONG. REC. 8,583 (1966) (vote for Dirksen amendment fails by thirteen votes in 1966). In the end, proponents of the Dirksen amendment voiced their support for an outdated cause. *See* 112 CONG. REC. 8,325 (1966)(quoting St. Louis Post-Dispatch saying "there is every reason to believe that Senator Dirksen is riding the deadest of dead horses . . . .").

[10]This phrase was used originally by Justice Douglas in Gray v. Sanders, 372 U.S. 368, 381. It reappeared in Justice Black's opinion in Wesberry v. Sanders, 376 U.S. at 18. The phrase re-surfaced in Reynolds v. Sims, 377 U.S. at 558, and at 587-88 (Clark, J. concurring). Although the slogan "one person, one vote" is itself empty of theoretically substantive meaning, it is a widely understood symbolic statement representing the commitment of the court to equally weighted votes for all citizens.

[11]For a review of these rules see Bickerstaff, *Reapportionment By State Legislatures: A Guide for the 1980's*, 34 SW. L. J. 607 (1980).

[12]*See infra* text accompanying note 100.

[13]Note that the *Reynolds* Court found that the equal protection clause demands "substantially equal state legislative representation for all citizens, of all places, as well as of all races." 377 U.S. at 568. The Court was not looking for just "fair and effective representation." *See infra* text accompanying note 201.

[14]*See infra* note 184 and accompanying text.

1960's have been used to create the complex holdings of the 1970's. And, in 1983, the Burger Court acted to confuse apportionment law even further.

B. The Bifurcated Court

On June 22, 1983, the United States Supreme Court released two decisions concerning state efforts to apportion[15] election districts.[16] The Court reached the decision in each case by a five to four vote, but the outcomes in the two cases were otherwise greatly dissimilar.[17] In *Karcher v. Daggett*,[18] the Court found a New Jersey apportionment statute[19] which provided for congressional districts with a maximum deviation of .6984% from the average to be in violation of article I, section 2 of the United States Constitution.[20] In contrast, the Court in *Brown v. Thomson*[21] sustained the Wyoming legislature's state representative system over an equal protection challenge despite an aggregate maximum interdistrict population variation of 89%.[22] Justices Brennan, Marshall, and Blackmun consistently opposed the validity of the challenged plans in *Karcher* and *Brown*,[23] while Chief Justice Burger, Justice Rehnquist, and Justice Powell consistently sought to uphold the constitutionality

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[15]Technically, apportionment is the task of allotting representatives to legislative districts. BLACK'S LAW DICTIONARY 91 (5th ed. 1979). Districting is the related task of defining the district boundaries. *Id.* at 427. In a larger sense, and as used by the Court in *Reynolds*, apportionment refers to the process of deciding whether to have districts, the number of districts to be created, the boundaries of these districts, and the numerical allocation of representatives to the districts. Any of these decisions may affect the weight given to a vote cast within the district. For this reason, this paper uses the term apportionment as used in *Reynolds*, and thus it includes districting.

[16]Brown v. Thomson, 462 U.S. 835 (1983); Karcher v. Daggett, 462 U.S. 725 (1983).

[17]In a single day, the Court approved its strictest ruling in congressional apportionment and the loosest in state legislative apportionment. The cases were dissimilar in other aspects as well. *See infra* note 30 and accompanying text.

[18]462 U.S. 725.

[19]1982 N.J. LAWS 1.

[20]The text of this clause provides:

> Representatives and direct Taxes shall be apportioned among the several States which may be included within this Union, according to their respective Numbers . . . . The actual Enumeration shall be made within three Years after the first Meeting of the Congress of the United States, and within every subsequent Term Meeting of the Congress of the United States, and within every subsequent Term of ten Years, in such Manner as they shall by Law direct. The Number of Representatives shall not exceed one for every thirty Thousand, but each State shall have at Least one Representative . . . . U.S. CONST. art. I, § 2, cl. 3.

[21]462 U.S. 835.

[22]*Id.* at 850 (Brennan, J., dissenting).

[23]*See Karcher*, 462 U.S. at 726 (Brennan, J., writing for the court, joined by Justices Marshall, Blackman, Stevens, and O'Connor); *Cf.* Brown v. Thomson, 462 U.S. at 850 (Brennan, J., dissenting with Justices White, Marshall, Blackmun joining).

of the plans.[24] The remaining Justices split their votes. Justices O'Connor and Stevens sided with the majority in each case, although each wrote a concurring opinion.[25] Justice White dissented in both cases.[26]

These voting records reveal much. Although nine judges voted in each case, only two justices agreed with both results. The dissatisfaction of the seven dissenting justices in the two cases is also reflected in the *Brown* concurrence in which Justice O'Connor, writing for herself and Justice Stevens, expressed "gravest doubts"[27] about the constitutionality of a statewide examination of the plan she and Stevens were voting to uphold. Their hesitant concurrence makes it appear that none of the Justices was truly satisfied with the cumulative results of the cases. The only uniformity on the Court in these decisions may be the conviction on the part of each group of Justices that the other Justices were going about their review of apportionment challenges incorrectly.[28] Ironically, it appears that none of the Justices wanted to challenge seriously the basic tenets of either *Reynolds* or *Wesberry*.[29]

Because all the Justices claimed *Reynolds* as precedent and because *Brown* was narrowly decided, *Brown* may have little precedential value.

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[24]*See Karcher*, 462 U.S. at 765 (White, J., dissenting with Justices Powell, Rehnquist, and Chief Justice Burger joining); *Cf. Brown*, 462 U.S. at 836 (Powell, J., writing for the Court, with Justices Rehnquist, Stevens, O'Connor, and Chief Justice Burger joining).

[25]*Karcher*, 462 U.S. at 744 (Stevens, J., concurring); *Brown*, 462 U.S. at 848 (O'Connor, J., concurring with Justice Stevens joining).

[26]*Brown*, 462 U.S. at 850 (White, J., joining dissent of Justice Brennan); *Karcher*, 462 U.S. at 765 (White, J., dissenting).

[27]*Brown*, 462 U.S. at 848 (O'Conner, J., concurring).

[28]*Brown*, 462 U.S. at 856 (Brennan, J., dissenting); *Karcher*, 462 U.S. at 766 (White, J., dissenting).

[29]The majority in *Karcher* began its analysis of the case using *Wesberry*. 462 U.S. at 730. The majority in *Brown* started its approach with *Reynolds*. 462 U.S. at 842. Likewise, Justice White's dissent in *Karcher* looked to *Reynolds* and *Wesberry* initially. 462 U.S. at 766 (White, J., dissenting). Although all the Justices claimed to base their views on *Reynolds* and *Wesberry*, their disagreement was fundamental, involving the propriety and direction of decisions in the apportionment area decided after 1964. For example, the dissenters in *Karcher* disagreed that the majority holding there — that there is no *de minimus* level below which congressional apportionment interdistrict population variations are not subject to judicial scrutiny — restated prior law from Kirkpatrick v. Preider, 394 U.S. 326 (1926). *Kirkpatrick* involved a challenge to Missouri's congressional redistricting which resulted in a maximum interdistrict population variation of 5.97%. *Id.* at 526. The Supreme Court expressly stated that no *de minimus* variance existed that would satisfy the "as nearly as practicable" approach of *Wesberry*. *Id.* at 530. *Karcher* did restate the *Kirkpatrick* holding, but the dissenting justices in *Karcher* were prepared to reexamine and overrule *Kirkpatrick*. *See Karcher*, 462 U.S. at 766 (White, J., dissenting).

The same Justices who dissented in *Karcher* created new law, however narrow its precedential value, in *Brown*. This was done by permitting an interdistrict population variation far greater than the generally understood limit of approximately sixteen percent. *Brown*, 462 U.S. at 850 (Brennan, J., dissenting). In contrast, the dissenters in *Brown* would have applied previous law, *id.* at 857-59, just as they had applied the established reasoning of *Kirkpatrick* to the resolution of *Karcher*.

The *Brown* decision's significance lies rather in the signals it sends. In state legislative apportionment cases, the Court by a bare majority appears to be prepared to move in a new direction, away from what had developed since *Reynolds*. For the first time since *Reynolds*, it was seen in *Brown* that a bare majority of Justices will accept gross variations in voting power equality for state legislative offices.

It is precisely because the Court did not elucidate in any manageable way when flagrant departures from equal population districts are permitted that *Brown* will spawn distress in legislatures, lower courts, and future Supreme Courts. *Brown* furthers the possibility of greater inequality in voting power at state legislative levels, and its language sidesteps any continued commitment to the purpose and goals of the equal protection clause.

An understanding of the stated and unstated sources of the principles used in *Brown* contributes to a rational explanation of the increasingly Byzantine rules of state legislative apportionment. If the sources of the current distress over state legislative apportionment are stated and understood, a way out of the current troubles may appear.

C. The Invisible Difference

Before *Brown* can be understood, it must be placed in the context of the Court's statements in *Karcher* about congressional reapportionment. The complete context is seen by treating the two cases as companion decisions. Only after such a review can the sources of distress in state legislative apportionment cases be traced to their origins.

The appearance of these two disparate opinions on the same day from the same Court seems disquieting.[30] After reading the cases, one is prompted to ask what sort of judicial theory it is that in the name of equality strikes down a scheme with a deviation of only .6984% as a violation of article I, section 2 of the Constitution while protecting a scheme which permits overrepresentation of voters by 89%. The anomaly of these two decisions urges an inquiry into why the Justices took their respective positions, and into how their theories take shelter under a Constitution which has no provisions expressly requiring the result in either case.[31]

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[30]Even if one knows that the Court uses different constitutional bases for requiring equality amongst districts depending on whether it is a congressional or state legislative plan, the results are disturbing. Despite all the difference in the language of the cases, both were decided on similar grounds. *See Karcher*, 462 U.S. at 744-49 (Stevens, J., concurring). *See also* Wesberry v. Sanders, 376 U.S. at 22 (Harlan, J., dissenting) (indicating that the court below and the appellants on appeal had argued that the fourteenth amendment controlled the issue of whether equally weighted votes were required in congressional districts).

[31]It is important to remember that both congressional districting schemes and state legislative districting plans are the product of state legislative actions. This fact makes

Some would argue that there is a rational basis for the different results reached in *Karcher* and *Brown*. The Court does use a different constitutional provision for each result.[32] Since 1964 when the Court used article I, section 2, to decide in *Wesberry* that congressional districts must be "as nearly as practicable" of equal population and used the equal protection clause of the fourteenth amendment to decide in *Reynolds* that the same rule applied to state legislative bodies, there has been potential for differences in the equality of interdistrict populations demanded by those two provisions. On one level, the Court's action in *Karcher* and *Brown* can be explained as the product of the distinction between state and congressional reapportionment schemes first explicity recognized in 1972 in *Mahan v. Howell*.[33] Since that time, the Court has occasionally voiced a different standard for the resolution of challenges to state legislative reapportionment plans than that used for congressional distribution cases.[34] The different results in *Karcher* and *Brown* could therefore be seen as the natural result of applying different bodies of law, developed from different constitutional provisions, to different "types" of apportionment cases.

The error in such an analysis is that even when the apportionment decisions were announced, the Court's use of article I, section 2 of the Constitution to decide *Wesberry* was seen as a subterfuge. As Justice Harlan pointed out in his *Wesberry* dissent, the congressional apportionment cases had risen to the Court on an equal protection claim.[35]

The error in using different constitutional provisions was most recently discussed by Justice Stevens in his concurrence in *Karcher*. Justice Stevens opined that "the holding in *Wesberry* as well as our holding today, has firmer roots in the Constitution than those provided by Article I, Section 2."[36] He reviewed the issues that congressional apportionment

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most Court language urging deference to the state legislative plans, while piling more restrictions on congressional plans, nonsensical. If the legislature is capable of meeting the requirements of congressional districting, it can certainly do state districting. Furthermore, prudence would mandate a reversal of the present scheme. It would be more logical to require greater scrutiny of legislative districting plans than of congressional plans, because in legislative plans self-interest is certainly a factor. For a discussion of the supposed "deference" to state lawmakers, see *infra* text accompanying notes 127-36.

[32]*See infra* note 36 and accompanying text.

[33]410 U.S. 3115 (1972)(The Court sustained a reapportionment plan for the Virginia legislature which contained a maximum interdistrict population variation of 16.4% even though it had disapproved smaller variations in congressional districts).

[34]*See, e.g.*, Brown v. Thomson, 462 U.S. 835 (1984); White v. Regester, 412 U.S. 755 (1973); Gaffney v. Cummings, 412 U.S. 735 (1973).

[35]*Wesberry*, 376 U.S. at 22 (Harlan, J., dissenting)(demonstrating that an equal protection analysis is more rational than an article I analysis for congressional districting because, by its express terms, article I applies to interstate representation while equal protection implies treating all citizens within a state's jurisdiction equally).

[36]*Karcher*, 462 U.S. at 745 (Stevens, J., concurring).

cases raise and concluded that equality of representation "is firmly grounded in the Equal Protection Clause of the Fourteenth Amendment."[37] He recognized that using different constitutional provisions in congressional apportionment cases and state legislative apportionment involves, at most, the creation of a transparent barrier between identical rationales. The underlying rationale of both the congressional and state legislative apportionment cases is what the Constitution requires of voting power as measured by the phrase "one person, one vote." Thus, it should be irrelevant which constitutional provision is used to reach the result. It is doubtful, therefore, that the different results in *Karcher* and *Brown* can be justified by appeals to federalism and by giving different meanings to "equality" in the context of different constitutional provisions.

It is also difficult to see the results in both cases as correct because the court was so divided on the merits.[38] The division of the Court throws doubt on the claim that the outcome of each case was foreshadowed by the dichotomy between congressional and state legislative apportionment cases. As indicated above, only two Justices agreed with the results in both cases.[39] If the results in *Karcher* and *Brown* were dictated by applying past distinctions, then the results should have had greater support among the members of the Court, even accounting for any ideological differences among those members. A four-member dissent represents substantial dissatisfaction with the rules or analysis that the majority used. The fact that only two members of the Court did not dissent in either of these cases suggests that a great majority of the Court is having difficulty applying the language of *Baker*, *Wesberry*, and *Reynolds*. Both *Karcher* and *Brown* reveal that the Justices seem to be satisfied with the language of the early reapportionment cases, but in strong disagreement about the resolutions those cases compel in recent apportionment disputes.[40] The judicial confusion and division in these two cases might lead some to conclude that Justice Frankfurter was correct when he observed that "[c]ourts ought not to enter this political thicket."[41] However, if he perceived correctly that there would be problems in handling apportionment cases, he incorrectly thought those problems would be political. Instead, the current problems in apportionment cases suggest a judicial thicket created by the Court itself by its confusion on how to use *Reynolds* and how to define equality.

The purpose of this Article is to examine the sources of the distress that has infected the Supreme Court and lower courts in the area of

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[37]*Id.* at 747.

[38]*See supra* notes 23-26 and accompanying text.

[39]*See supra* note 25 and accompanying text.

[40]*See supra* notes 27-29 and accompanying text.

[41]Colgrove v. Green, 328 U.S. 529, 556 (1946).

state legislative apportionment twenty years after *Reynolds* held out the promise of equality of voting power for all. This examination is accomplished by asking why the equality of *Wesberry* and *Reynolds* was affirmed in *Karcher*, but came to be disregarded in *Brown*. It appears that the current judicial thicket has sprung from misapplied deference to state legislative action, unwarranted concessions to bicameralism, totemic respect for political subunits, and unexplainable reliance on incumbency, voter strength, political factors, and history. In addition, therefore, this Article seeks to explore the source of these factors, their policy bases, their rationality, and the extent to which they contribute to judicial rancor over state legislative apportionment. This article will also explore the consequences of permitting these sources to cause different treatment of state legislative apportionment. Solutions will be proposed to remedy both the judicial distress currently observed and its sources.

II. The Cases

A. Karcher v. Daggett

Following the 1980 federal census, the federal government notified New Jersey officials that, based on its current population, it was only entitled to fourteen congressional representatives.[42] This required that the state be reapportioned into fourteen districts. Two separate legislatures passed reapportionment bills.[43] The second of these bills, S-711, also known as the Feldman Plan, was the source of the litigation in *Karcher*.[44]

The Feldman Plan provided for fourteen congressional districts. These districts varied from a population low of 524,825 to a population high of 527,427. The maximum difference between the districts was 3,674 people, or 0.6984% of the average district.[45] A number of plaintiffs, including Republican congressional representatives, challenged this districting as a violation of article I, section 2 of the Constitution.[46] A three-member district court heard the case and held that because there were other reapportionment plans available with substantially lower interdistrict population variations there had not been a good faith effort to reduce population disparities between districts. The trial court rejected the defendant's claim that deviations smaller than the statistical error of the latest census meant "equality" for purposes of article I, section 2. Additionally, the court found that the alleged goals of the legislature

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[42]*Karcher*, 462 U.S. at 727 (1983).

[43]*Id.*

[44]*Id.* at 727-28. The Feldman Plan was codified at N.J. Stat. Ann. § 19:46-5 (West Supp. 1983).

[45]*Karcher*, 462 U.S. at 728.

[46]*Id.* at 729.

in selecting the plan could not justify the population deviation in that plan.[47]

On appeal, Justice Brennan, writing for a five-person majority, agreed with the lower court's disposition of the case.[48] In reaching this conclusion, Justice Brennan employed a standard two-part test taken from *Kirkpatrick v. Preisler*[49] to determine the constitutionality of the proposed congressional districting plan. First, the Court examined the plan to discern whether "the population differences among districts could have been reduced or eliminated altogether by a good-faith effort to draw districts of equal population."[50] Only if no good faith effort were found would the Court reach the second step of evaluating the state's goal in creating the disparities to see if the goal was legitimate. In order to reach an answer to the question of good faith, the Court had to resolve whether a population variation below one percent (or the marginal undercount in the census tally of New Jersey's population) met the constitutionally required "good faith" effort to achieve population equality.[51]

The Court rejected New Jersey's attempt to rely on the undercount margin as a *de minimus* level under which a districting plan would not be subject to constitutional scrutiny.[52] The Court stated that the ideal of equal representation was best served by using the "best population data available";[53] any level of *de minimus* population variations precluding judicial review would be arbitrary and invite greater population disparities than necessary in a world with computers and calculators. Because the Court found that mere "statistical imprecision does not make small deviations among districts the functional equivalent of equality,"[54] it considered evidence that plans with smaller deviations had been available to the legislature demonstrative of the fact that a good faith effort to achieve population equality had not been made.[55]

Because there had not been a good faith effort to achieve population equality among the districts, the state was required to meet the second test and demonstrate that some legitimate goal was served by the population disparities.[56] The state tried to justify the population variation between districts as a state plan to preserve minority voting strength,

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[47]*Id.* at 729-30.

[48]*Id.* at 727.

[49]394 U.S. 526 (1969).

[50]462 U.S. at 730.

[51]*Id.* at 731, 735-36.

[52]*Id.* at 738.

[53]*Id.* (quoting *Kirkpatrick*, 394 U.S. at 528).

[54]*Id.* at 735.

[55]*Id.* at 738-39.

[56]*Id.* at 740. Justice Brennan listed some of the items which might serve as legitimate goals for population disparities: a desire for compactness, a respect for municipal bound-

but this claim was not supported by the evidence.[57] Thus, the majority found that the very small population differences between congressional districts within New Jersey were forbidden by the Constitution; the differences could have been avoided and were not justified by some legitimate objective capable of specific description and verification.[58]

Justice Stevens, in his concurrence, stressed his agreement with the majority, but focused on problems that can arise in equal population districts where there has been gerrymandering to dilute a particular group's voting strength.[59] His opinion outlined ways "politically salient" classes could challenge reapportionment plans that deny them fairness in the political process.[60] In particular, he emphasized that numerical equality was only one criterion for measuring the neutrality of a proposed apportionment plan.[61] His opinion served to emphasize that even if a plan in question could be sustained because its population variation was *de minimus*, it might be successfully challenged on other grounds. He hinted that the deviations in population in *Karcher* were not based on neutral and therefore legitimate criteria and that this might be revealed by simply examining the shape of the districts.[62] Finally, Justice Stevens' opinion served as a plea for the fulfillment of the aims of *Wesberry* and *Reynolds*.[63]

The dissenting opinions in *Karcher*, written by Justices White and Powell, stated that the population variation in the New Jersey plan should survive constitutional scrutiny.[64] The dissenters found persuasive an argument that some *de minimus* level existed below which a court could not question the sources of interdistrict population variations.[65] This position would have required overruling *Kirkpatrick v. Priesler*, a 1969 congressional redistricting decision rejecting that same argument.[66]

Justice White's dissent strongly criticized the majority for reading the Constitution as inflexibly requiring strict population guidelines.[67] White also criticized the majority for overruling *sub silentio* parts of *Kirkpatrick* by listing as acceptable state goals criteria rejected in *Kirkpatrick*; White urged recognition of the fact that the majority had already tacitly overruled part of *Kirkpatrick* in stating that "any number of

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aries, a desire to preserve the core of prior districts, and a desire to avoid a contest between incumbent representatives. *Id.*

[57] *Id.* at 742-44.

[58] *Id.* at 744.

[59] *Id.* at 744 (Stevens, J., concurring).

[60] *Id.* at 754-55.

[61] *Id.* at 751-53.

[62] *Id.* at 755, 762.

[63] *Id.* at 765.

[64] *Id.* at 782-83 (White, J., dissenting), 784 (Powell, J., dissenting).

[65] *Id.*

[66] 394 U.S. 526 (1967).

[67] *Karcher*, 462 U.S. at 766 (White, J., dissenting).

consistently applied legislative policies might justify some variance."[68] White's dissent sought the application of a more flexible principle that had prevailed in state legislative apportioning cases. He would have selected a lower level of *de minimus* population variation than is accepted in state legislative apportionment cases, but he would still choose an arbitrary point below which the Constitution would not require scrutiny.[69]

Justice Powell wrote a separate dissent to express his views on the potential impact on gerrymandering that he perceived the holding in *Karcher* would have.[70]

B. Brown v. Thomson

Justice Powell wrote the majority opinion in *Brown v. Thomson*,[71] narrowly identifying the issue as "whether the state of Wyoming violated the Equal Protection Clause by allocating one of the sixty-four seats in its House of Representatives to a county the population of which is considerably lower than the average population per state representative."[72] The plaintiff in the case challenged a 1981 Wyoming statute[73] providing for a representative for Niobrara County, even though the population of Niobrara County was 60% lower than the average population per representative district.[74] Based on Wyoming's population,[75] an "ideal" district would have contained 7,377 individuals. The population of Niobrara County at the time was 2,924.[76] The statutory scheme resulted in a maximum deviation of 89% between state districts.[77] The legislative plan also provided that if the grant of a representative to Niobrara County was declared unconstitutional, the county would then share a representative with the neighboring county of Goshen.[78] The legislature of Wyoming acted under a state constitutional provision requiring that every county be used as a representative district.[79] Indirectly, therefore, the case presented the issue whether the state's constitutional provision, which directed that a district be composed of individual counties for the state House of Representative seats, was permissible under the federal Constitution.[80]

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[68]*Id.* at 779.

[69]*Id.* at 781-82. Justice White considered any interdistrict population variation below 5% *de minimus* and unworthy of constitutional review. *Id.* at 782.

[70]*Id.* at 784 (Powell, J., dissenting).

[71]462 U.S. at 835.

[72]*Id.* at 837.

[73]WYO. STAT. § 28-2-109 (1982).

[74]*Brown*, 462 U.S. at 843.

[75]Wyoming's population was given as 469,557. *Id.* at 839.

[76]*Id.*

[77]*Id.*

[78]*Id.* at 840.

[79]WYO. CONST. art. III, § 3.

[80]*Brown*, 462 U.S. at 846.

A three-member district court upheld the constitutionality of the statute, largely because similar apportionment plans had been sustained previously.[81] Additionally, the court found that the extra interdistrict population variation attributable to giving Niobrara County a representative was negligible when compared to the statewide deviation figure.[82] Apparently, the maximum statewide interdistrict population deviation without including a Niobrara County representative would have been 66%. Because the state's plan to add a Niobrara County representative "only" raised the maximum deviation by 23%, the Court claimed it was only validating this marginal increase in the maximum interdistrict population deviation.[83]

On appeal, Justice Powell's short majority opinion reaffirmed the validity of the *Reynolds v. Sims* requirement that "the seats of both houses of a bicameral state legislature must be apportioned on a population basis."[84] The majority, however, reasoned that the rule "requires *only* that a State make an honest and good faith effort to construct districts . . . as nearly of equal population as is practicable."[85] Powell opined that minor deviations in state legislative districts do not warrant constitutional scrutiny, and that even more substantial variation in population districts is tolerable if there is a satisfactory explanation grounded on "acceptable" state policy.[86]

The *Brown* majority found that Wyoming's use of Niobrara County as a unit of representation was acceptable because it was "the result of the consistent and nondiscriminatory application of a legitimate state policy" of treating counties as representative districts.[87] The Court did not require that the "consistent and legitimate" state policy be some state goal separate from its apportioning procedure. Thus, instead of requiring a state policy of "furthering rural interest," for example, the Court implied that merely a policy of treating voters unequally is legitimate if consistent, nondiscriminatory, and done statewide.

The Court attempted to minimize its action in sustaining a plan

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[81]Brown v. Thomson, 536 F. Supp. 780, 783 (1983).

[82]*Id.*

[83]*Id.* at 783-84.

[84]*Brown*, 462 U.S. at 842 (quoting Reynolds v. Sims, 377 U.S. 533, 568 (1964)).

[85]*Brown*, 462 U.S. at 842. (quoting Reynolds v. Sims, 377 U.S. at 577). Justice Powell added the preface of the word "only" to the requirement. This may indicate a minimization of the meaning of "good faith" effort.

[86]*Id.* at 842-43.

[87]*Id.* at 844. The Court tempered its reasoning concerning state policies requiring interdistrict population variations by saying that not any size variation would be accepted merely by following such a consistent and acceptable state policy of treating counties as representative districts. *Id.* at 844-45. One reason the Court may have done this is that any policy advanced as a purpose for the unequal apportionment would be, by definition, discriminatory.

with an 89% maximum deviation by only considering the deviation resulting from the Niobrara district. The majority did not attempt to validate a statewide plan that contained population deviations of the magnitude of the Wyoming plan. Thus, the Court mirrored the lower court's reasoning that only the 23% addition to the maximum interdistrict population variation created by granting Niobrara County a representative would go into the balancing text.[88]

The concurrence of Justices O'Connor and Stevens was vital to the resolution of *Brown*. As noted above, the concurrence stressed that the sole reason for concurring with the majority was the fact that the plaintiffs attacked only the grant of a representative to Niobrara County and not the statewide plan.[89] O'Connor made this observation despite her recognition that there existed great flexibility in applying constitutional standards of equality to accommodate state policies.[90] O'Connor and Stevens, therefore, limited *Brown* to a less-than-statewide attack on apportionment based on county lines.

The position of O'Connor and Stevens, however, is irreconcilable with the majority's express reliance on a consistent and neutral "statewide" plan to counterbalance the disparities in the Wyoming plan.[91] If it is permissible to urge a statewide policy as justification for voting power inequality, one cannot ignore the statewide consequences of a particular application of that policy.

Justice Brennan, writing for the four dissenters, argued that when viewed either in isolation or in the context of a faulty statewide scheme, the apportionment of a representative to Niobrara County was constitutionally defective.[92] Brennan outlined the four-part test that has evolved to evaluate state level representative apportionment plans.[93] First, a 10% variation is required to obtain constitutional scrutiny for a state districting plan.[94] Second, any deviations greater than ten percent might be justified by a showing of "legitimate considerations incident to the effectuation of a rational state policy"[95] which are free of "any taint of arbitrariness."[96] Third, the state must demonstrate that the inequalities exist only to further legitimate state interests and that the inequalities go no further than necessary to achieve those interests.[97] Brennan asserted that the final prong of the test prevents any plan from attaining constitutional

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[88] *Id.* *See also supra* text accompanying note 82.
[89] *Brown*, 462 U.S. at 850.
[90] *Id.* at 848.
[91] *Id.* at 843.
[92] *Id.* at 853 (Brennan, J., dissenting).
[93] *Id.* at 852.
[94] *Id.*
[95] *Id.* (quoting *Reynolds*, 377 U.S. at 579).
[96] *Id.*
[97] *Id.*

approval if the deviations are so large as to subvert the concept of equal representation.[98]

In applying this four-part test to the Wyoming apportionment plan, Brennan discovered that in addition to the variations in Wyoming's plan far exceeding the 10% *de minimus* level, the reasons proferred by the state for the variations could not justify the magnitude of the variations found either singly or across the state.[99] He pointed out that Wyoming's defense of population variations, sparseness, and uniqueness had been previously rejected, and he noted that allowing the voters of Niobrara County up to three times the voting power of other state citizens was directly at odds with dicta in *Reynolds*.[100] Brennan also attacked the majority's refusal to consider the Niobrara County representative in the context of the statewide interdistrict population variation.[101] Ultimately, Justice Brennan and the other dissenters could only take comfort in pointing out the narrowness of the holding.[102]

III. Sources

The source of the difficulties facing judges in state apportionment cases such as *Brown* can be traced to language in *Reynolds v. Sims*.[103] The Court decided in *Reynolds* and related cases to apply the "one person, one vote" rule to state legislative apportionment. Although *Reynolds* adopted the goal of equal population districts, the Court introduced language which suggested exceptions that could eventually be used to undermine the equality demanded in that opinion. Inevitably, the *Reynolds* opinion was subjected to detailed examination. Minor omissions and overlooked arguments have been a source of many severe criticisms of *Reynolds*. Almost no attention, however, has been given to dicta in *Reynolds* used since 1964 to undercut its primary commitment to equality of voting power.

Although this dicta has not been well examined, several critics of the reapportionment decisions have focused their attention on the fact that *Reynolds* did not take into account the theories of representation that are necessary to decide intelligently what the Constitution requires.[104] Justice Frankfurter, the source of this type of criticism, was correct in

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[98]*Id.*

[99]*Id.* at 853-54.

[100]*Id.* at 854-55.

[101]*Id.* at 850-51.

[102]*Id.* at 850.

[103]377 U.S. 533.

[104]*See, e.g.*, Note, *Reapportionment on the Substate Level of Government, Equal Representation or Equal Vote*? 50 B.U.L. Rev. 231 (1970). *See also* Lee and Herman, *Ensuring the Right to Equal Representation: How to Prepare or Challenge Legislative Apportionment Plans*. 5 U. Hawaii L. Rev. 1 (1983).

his dissent in *Baker v. Carr*[105] that the decision chose between competing theories of representation.[106] Such criticism, however, ignores the reality of constitutional litigation; any reapportionment case will pose specific questions regarding the permissibility of a challenged plan. Admittedly, resolving concrete questions will always involve examining some theoretical aspect of representation, but never will a comprehensive review of all possible representational theories be possible. The fact that the Court must consider representative theories piecemeal, however, is no ground for saying that the issues should never be heard at all. Moreover, the "case and controversy" requirement of article III prevents the Court from addressing the issues abstractly.

Critics respond to this observation by saying that, if the Court cannot consider the competing theories completely, the issues are too "complex and subtle" for judicial resolution.[107] There are two flaws in this argument. First, this criticism overlooks the fact that the inequalities objected to in the early reapportionment cases were inadvertant and frequently in violation of specific state constitutional provisions.[108] Second, the call for the Court to defer to legislative bodies overlooks the legislative origins of the fourteenth amendment's commands.

With respect to the first flaw, the legislative bodies this criticism seeks to bestow with an exclusive right to resolve the "complex and subtle" competing theories of political representation had not done so, or had done so in violation of their own local constitutional provisions. Even where representational theories had been considered, the result was to validate the status quo.[109] There is nothing "subtle" about clear violations of state law. The theme resounding from apportioning plans attacked in the 1960's was that of self-serving politicians ignoring their own state constitutional commands in order to maintain power.[110] The Court's opinion simply responded to the blatant inactivity of legislatures regarding apportionment.[111]

The second criticism, that the Court should defer to a legislature

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[105]Baker v. Carr, 369 U.S. at 300 (Frankfurter, J., dissenting).

[106]*Id.*

[107]*E.g.*, Rossum, *Representation and Republican Government: Contemporary Court Variation on the Founders' Theme*, 23 Am. J. Juris. 88, 95 (1978) (referring to Justice Fortas' comment in Avery v. Midland County, 390 U.S. 474 (1968)).

[108]Averbach, *The Reapportionment Cases: One Person, One Vote — One Vote, One Value*, 1964 Sup. Ct. Rev. 1, 46; Lee and Herman, *supra* note 104, at 3.

[109]*See, e.g.*, Lucas v. Forty-Fourth General Assembly of Colorado, 377 U.S. 718. *See also* Lee and Hermann, *supra* note 104, at 3.

[110]*Reynolds*, 377 U.S. 540, 553; *Cf.* Baker v. Carr, 369 U.S. at 191 (Tennessee failed to comply with state constitution for over sixty years requiring substantially population-based reapportionment every ten years.). *See also* Lee and Hermann, *supra* note 104, at 3. 3.

[111]*Reynolds*, 377 U.S. at 568.

which could discuss the "complex and subtle" issue in representational theory, is inapt; that is actually what the Court did. The draftsmen of the fourteenth amendment provided the Court with specific language requiring equal protection for citizens under state laws.[112] In construing the fourteenth amendment to require voting power equality, the Court necessarily implied that the "complex and subtle" issues of representational theory were settled by giving "equal protection" constitutional status by the amendment process. The various lawmakers and assemblies ratifying the fourteenth amendment had passed judgment on the issue and had decided on equality. In the context of apportionment, the Court merely used a functional definition of equality, a test an ordinary American would understand — "one person, one vote." The Court did not act as an academic commission or theoretical "think tank" to uncover all possible meanings of equality.

When the Court looked closely at the fifty governments of the United States of America, it discovered that, in a country which prided itself as being the home of free and equal people, the reality was that, as the term was commonly understood, people were not being treated "equally" by their state governments. In 1964, the Court found itself in the position of being the boy-tailor observing the emperor in his new suit. The cloth of popular equality had never been spun in many of the states, and the Court's responsibility was to announce that fact publicly to the parties before it. In *Reynolds v. Sims*, there may have been competition among various theories of representation, but, more pragmatically, there were simply facts demonstrating the gap between what the constitutions of both the United States and Alabama professed to require and the reality of 1962 voting power inequalities in Alabama.

The genius of the Court's solution to this problem in the form of the "one person, one vote" rule was its utter simplicity.[113] This solution surely meant, broadly speaking, that, in the United States, under the post-Civil War Constitution, majority rule *is* the rule in the selection and operation of the legislature and that, roughly speaking, the equal protection clause requires equal treatment of people's votes regardless of their status, location, or politics.[114] Theories of proportional representation, qualitative representation, direct representation, and indirect representation are only tangentially related to this basic concept.[115] Thus,

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[112]The fourteenth amendment provides in part: "nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws." U.S. CONST. amend, XIV, § 1.

[113]ELY, *supra* note 5, at 121.

[114]*See Reynolds*, 377 U.S. at 565 ("Logically, in a society ostensibly grounded on representative government, it would seem reasonable that a majority of the people of a State could elect a majority of that State's legislators. . . .[T]he concept of equal protection has traditionally been viewed as requiring the uniform treatment of persons standing in the same relation to the governmental action questioned or challenged.")

[115]*See* Rossum, *supra* note 107, at 104-109. (*Reynolds* Court was not sensitive to

the main criticisms of *Reynolds* do not survive sustained scrutiny. The Court was not faced with the task of examining all representation theories, and it used a pragmatic definition of equality to enforce the nationally-created mandate of equality.

A. Method of Review

Even though those criticisms have failed, *Reynolds* has caused subsequent difficulty. One of the major sources of distress in state legislative apportionment cases stems from the dicta in *Reynolds* that both established a firm rule to guide lower courts and rendered uncertain the strength and dimensions of that rule.

In announcing the holding in *Reynolds*, the Court stated that, "as a basic constitutional standard, the Equal Protection Clause requires that the seats in both houses of a bicameral state legislature must be apportioned on a population basis."[116] This rule, as stated, captures the simple "one person, one vote" standard in instructive and plain language.[117] Elsewhere in its opinion, however, the *Reynolds* Court made it clear that this rule was not as definite as it appeared. The Court's language distorted the scale with which trial court judges could measure individual cases. The Court opted to thrust flexibility into its manageable "basic Constitutional standard":

> [W]e deem it expedient not to spell out any precise constitutional tests. What is marginally permissible in one state may be unsatisfactory in another, depending on the particular circumstances of the case. Developing a body of doctrine on a case-by-case basis appears to us to provide the most satisfactory means of arriving at the detailed constitutional requirements in the area of state legislative apportionments.[118]

This case-by-case approach is not dissimilar from what the Court

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questions of reflective, quantitative, and indirect representation). *See also* Lucas v. Forty-Fourth General Assembly of Colorado, 377 U.S. 713 (1964). In *Lucas* there appeared to be a competing political philosophy accepted by a majority of the voters of the state. It cannot be said with any certainty, however, whether the approving voters were approving a political philosophy or the particular political regime then in power that had stagemanaged the wording of the proposed amendments and politicized each proposal *See id.* at 731-32. In any event, the political philosophy advanced there, if it truly was one, was illegitimate precisely because it attempted to contravene controlling federal constitutional precepts.

[116]*Reynolds*, 377 U.S. at 568.

[117]ELY, *supra* note 5, at 121. Ely has praised the "one person, one vote" rule for its manageability. Regardless of the degree of alteration in state legislatures such a rule would require, it at least has the benefit of being easily applied. The risk, of course, especially in a computer age, is that it will be applied too well without judicial intervention to prevent equipopulous gerrymandering. Justice Steven's approach to combat this problem was outlined in *Karcher*, 462 U.S. at 744 (Stevens, J., concurring). *See, e.g.*, Davis v. Bandemer, No. 84-1244 (U.S. oral argument heard Oct. 7, 1985) (decision pending).

[118]*Reynolds*, 377 U.S. at 578.

has done in other areas of constitutional law,[119] and this approach would undoubtedly have been appropriate if the Court had been merely returning a new doctrine to lower courts for growth and evolution. Such, however, was not the case. Instead, *Reynolds* both gave to and took from lower courts. The Court admiringly said in *Reynolds* that the lower court had been correct in recognizing that "legislative reapportionment is primarily a matter for legislative consideration and determination, and that judicial relief becomes appropriate only when a legislature fails to reapportion according to federal constitutional requisites in a timely fashion . . . ."[120] By this wording, the Court returned the issue to state legislatures *and* lower courts.

The inherent contradiction of urging case-by-case review of apportionment legislation and urging judicial deference to state legislative decisions on apportionment was not immediately apparent after *Reynolds*. In the next several state apportionment cases to rise to the United States Supreme Court, there was a trend towards developing constitutional rules on a case-by-case basis. For example, in *Mahan v. Howell*,[121] the Court approved permitting states to justify fairly substantial deviations in interdistrict population by relying on a policy of preserving political boundaries.[122] At the same time, however, the Court indicated that the range of the deviation accepted there, 16%, was probably the greatest that the Constitution would permit.[123] In *White v. Regester*[124] and *Gaffney v. Cummings*,[125] the Court permitted evolution in state legislative apportionment law by accepting the claim that interdistrict population variations below 10% were *de minimus* and therefore not subject to constitutional review.[126]

The combination of the judicial rules from *Mahan*, *Gaffney*, and *White* established a basic guideline for legislatures to follow in districting. The guidelines, while perhaps not mandating the equality originally envisioned in *Reynolds*, did provide a workable scheme for a state legislature faced with the task of reapportionment. A legislature knew that any deviation it permitted below ten percent was free from scrutiny. Thus, any policy behind establishing unequal districts did not need to be articulated if the interdistrict population variation was less than 10%.

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[119]*See, e.g.*, Bivens v. Six Unknown Named Agents of Federal Bureau of Narcotics, 403 U.S. 388 (1971) (reversing a dismissal of a claim for a private cause of action against governmental agents for violation of the petitioner's fourth amendment rights, without providing an exhaustive outline of when such actions are possible).

[120]*Reynolds*, 377 U.S. at 586.

[121]410 U.S. 315 (1972).

[122]*Id.*

[123]*Id.* at 392.

[124]412 U.S. 755 (1973).

[125]412 U.S. 735 (1973).

[126]*White*, 412 U.S. at 764; *Gaffney*, 412 U.S. at 745.

A legislature also knew that if it wished to preserve that state's constitutional requirements or its own policy of honoring county lines, a plan with around a 16% interdistrict variation would be permitted. The legislature knew that any variation beyond that point was not permissible.

The rules in *Mahan*, *Gaffney*, and *White* were created by judicial review of apportionment. Elsewhere, however, there was simultaneous development of the Court's language urging deference to state legislatures. In 1966, the Warren Court, in *Burns v. Richardson*,[127] made it clear that it was seeking to avoid as much as possible any confrontation with state legislatures. The Court indicated that a "state's freedom of choice to devise substitutes for an apportionment plan found unconstitutional either as a whole or in part, should not be restricted beyond the clear commands of the Equal Protection Clause."[128]

Given this sensitivity toward state governments, it is not surprising that the Burger Court would use the concern for state legislative power embodied in the cautionary wording of *Reynolds* to lower the level of scrutiny given state legislative districting plans. On the surface, this attitude toward reviewing apportionment plans would prevent judicial intrusion into the sphere of the various state legislatures. As the Court stated in *Gaffney*, "We doubt that the Fourteenth Amendment requires repeated displacement of otherwise appropriate state decision making in the name of essentially minor deviations."[129] This language suggests that the deference to state legislatures developed after *Reynolds* went hand-in-hand with the case-by-case approach of developing subsequent rules outlining the permissible deviations from equality in state legislative apportionment.

The breakdown of harmony between the rules on deference and the case-by-case approach occurred in *Brown*. The clash seems, in retrospect, to have been inevitable. These policies could exist in uneasy tension only so long before one or the other had to give way. Courts can develop legal guidelines on a case-by-case basis; legislatures, however, need constitutional-style or legislative-style "hard and fast" rules in order to fulfill their functions without perpetual fear of subsequent judicial invalidation. A firm "one person, one vote" rule would be easy for a state legislature to apply and for a court to require.[130] Any deviation, no matter how small, would result in invalidation. On the other hand, a flexible, case-by-case rule requires that every state legislative judgment be scrutinized by a court to see if the constitutional minimums have been honored. Therefore, as is sometimes recognized, the most "intrusive" rules, such as a solid "one person, one vote rule," are actually

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[127]389 U.S. 73 (1966).

[128]*Id.*

[129]412 U.S. at 749.

[130]*See infra* text accompanying note 144.

less intrusive because they do not require individual examination of every legislative act.[131]

Brown v. Thomson[132] is a premier example of the clash between the urge to follow the case-by-case approach and the urge to defer to state legislatures.[133] Rather than abide by the detailed constitutional requirements that had grown up following *Reynolds*, the Court in *Brown* opted to side with the theory of deference to state legislatures. This rendered uncertain the previously developed standards evolved by the case-by-case approach.[134] Thus, both courts and legislative bodies are now in doubt as to whether any stable limit exists to the permissible interdistrict population variations in state apportionment.

After *Brown*, each entity responsible for apportionment in a state must guess whether the policies it selects that call for population variation between districts can be sustained. Courts reviewing such cases know only that precedentially developed guidelines mean little, while deference to the legislature means much. The guesswork both courts and legislatures must engage in following *Brown* invites misunderstanding, confusion, and hostility between the judicial and legislative branches of state governments. By granting deference to state legislative decisions, the Court effectively called upon transitory majorities in legislatures to maximize numerical inequalities detrimental to their opponents. Additional litigation can be anticipated, with each side legitimately claiming *Reynolds* as support for its position. It should not be surprising that extreme rancor and hostility will erupt on benches handling such problems and among the parties in the proceedings.[135]

Because the Court's action in *Brown* requires an intense scrutiny of every case, a court will have to spend a great deal of time judging whether the claim is unique. This laborious and costly review process in federal and state courts could be avoided if a hard and fast line were drawn demarcating the permissible and the impermissible extent of interdistrict population variation. Only then will legislatures truly be free to draw district lines knowing their choices are constitutionally sound; and only then will courts called to review apportionment claims have a rule which inspires confidence in their decisions. Until that time, other states can set up factors like those used in Wyoming to justify creating

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[131]ELY, *supra* note 5, at 124-25.

[132]462 U.S. 835.

[133]As the dissent in *Brown* pointed out, it was clear that the previously decided case had never approved of anything near the interdistrict population variation accepted there. *Id.* at 854 (Brennan, J., dissenting).

[134]The concurrence of Justices O'Connor and Stevens in *Brown* makes this uncertainty greater, because it is unclear whether they would support the consequences and reasoning of *Brown* on other facts.

[135]*See infra* notes 146-78 and accompanying text.

an exalted class of voters.[136] The victory of the deferential strand of *Reynolds* threatens to obliterate functional limits of inequalities in voting power.

B. Intrusiveness — the Rule on State Constitutional Contradictions

Closely allied to *Reynolds*' conflicting directions regarding whether a case-by-case approach or a completely deferential approach is the proper method of reviewing apportionment plans is the Court's language granting deference to state constituional provisions. The result forces both legislatures and courts to walk a tightrope between conflicting provisions of state constitutions and the federal Constitution.

Provisions of state constitutions often arise as obstacles to good faith attempts by legislatures to maximize the voting equality of citizens in their states. For example, a Tennessee legislature's plan to create districts as close to equal as possible was struck down by the Tennessee Supreme Court for violating a state constitutional provision limiting districts to county boundaries.[137] The absurdity in the recent Tennessee case arose as the product of deferential and seemingly innocuous language in *Reynolds*. The Court in *Reynolds*, while making its bold decision to invalidate many states' apportionment plans, tempered the effect by saying in its discussion of the remedies that "clearly, courts should attempt to accommodate the relief ordered to the apportionment provisions of state constitutions insofar as is possible."[138]

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[136]*See Brown*, 462 U.S. at 857 (Brennan, J., dissenting) ("Why, then, is it permissible to create such an exalted class based on location of residence?").

[137]State *ex rel.* Lockert v. Crowell, 656 S.W.2d 836 (1983). There is suitable irony in this in that Tennessee's inequality had prompted the suit in *Baker v. Carr*, which ushered in the review of apportionment plans. Tennessee was now being told that its efforts to promote equality were too good, that the legislature had advanced equality too much. In State *ex rel.* Lockert v. Crowell, the Tennessee court reached the awkward result of invalidating apportionment legislation because it created too much equality among districts. *Id.* at 840. The legislature had achieved its goal of near perfect equality by crossing county lines in the creation of the districts, assuming that the demands of *Reynolds* meant that the state constitutional restriction on crossing county lines was invalidated. The court's holding mirrored the rule in other jurisdictions that although the equal protection clause of the federal Constitution prevailed in any direct conflict with state constitutional provisions, unless absolutely necessary the state could not cross county lines in order to reach the lowest deviation in interdistrict population equality. *Id.* Of course, when it is "necessary" to cross county lines in order to achieve a plan that will meet court approval was unknown to the legislature during creation of the apportioning legislation. Court intrusion must occur in such a situation under present apportionment guidelines.

The Tennessee Supreme Court was following a similar body of law developed in Texas in Clements v. Valles, 620 S.W.2d 112 (Tex. 1981), and Smith v. Craddick, 471 S.W.2d 375 (Tex. 1971). The courts there reached the conclusion that state constitutional provisions against crossing county lines in apportionment were valid, except to the limited extent such crossings had to occur in order to comply with the federal Constitution. *Clements*, 620 S.W.2d at 115; *Smith*, 471 S.W.2d at 379.

[138]*Reynolds*, 377 U.S. at 584.

The clearest language limiting a court's ability to tamper with a state's constitution appeared in *Minnesota State Senate v. Beens*,[139] where the lower court had ordered a wholesale restructuring of the bicameral legislature in Minnesota.[140] The Supreme Court reversed, saying that the special deference given to state constitutions also extends to legislation passed under direction of the state constitution.[141] Thus, the lower court was bound by the mere policy of previous Minnesota legislatures as to the size of the legislature because the state constitution delegated the decision on size to the legislature.[142] By this decision, the Supreme Court made it clear that the equal protection clause, which guarantees equality to all citizens of the land, would, in matters of apportionment, take a backseat to the polymorphous state constitutional restrictions found across the country. The equal protection clause would require overriding state constitutional nonpopulation requirements for apportionment only "to the extent necessary" to require apportionment "substantially" on a population basis.[143]

While in theory it may seem wise to permit state constitutional restrictions on apportionment to bind legislators except where "absolutely necessary" to effect substantial equality, the practical result is irrational, in part because the Court has never produced a test to determine when it is "absolutely necessary" to invalidate state constitutional apportionment restrictions. The functional tests of 10% as the threshold of scrutiny and 16% as the maximum allowable deviation were eliminated by *Brown*,[144] so that neither legislatures nor courts know with any certainty when it is necessary to set aside a state constitutional apportionment restriction. Only rarely has a state court found it wise to adopt the more manageable rule that any nonpopulation-based apportionment requirements which violate the equal protection clause of the federal Constitution are void.[145] Failure to follow this rule is not conducive to judicial economy or to serious progress toward equalizing the voting power of citizens.

An Idaho decision presents a particularly poignant example of the current dilemma that state legislative reapportionment creates. In *Hellar v. Cenarrusa*,[146] the Supreme Court of Idaho became the scene of an

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[139]406 U.S. 187 (1972) (per curiam).

[140]*Id.* at 196.

[141]*Id.* at 196-97.

[142]*Id.*

[143]*Cf. Lockert v. Crowell*, 656 S.W.2d at 838.

[144]462 U.S. at 855 (Brennan, J., dissenting).

[155]*Cf.* Logan v. O'Neill, 187 Conn. 721, 448 A.2d 1306 (1982); *In re* Reapportionment Plan for the Pennsylvania General Assembly, 497 Pa. 525, 442 A.2d 661 (1981).

[146]104 Idaho 858, 664 P.2d 765 (1983), *on appeal after remand*, 682 P.2d 524 (Idaho 1984), *order following legislative enactments*, 682 P.2d 538 (Idaho 1984), *opinion on final order*, 682 P.2d 539 (Idaho 1984) (Hereinafter referred to as *Hellar I*, *Hellar II*, *Hellar III*, and *Hellar IV*, respectively).

emotional and stressful confrontation among the state's judicial and legislative branches, the state and federal constitutions, and conflicting language and theories in Supreme Court opinions. The problems began with an apparently simple challenge to Idaho's 1982 reapportionment law.[147] Before the final decision was rendered, charges of unprofessional and unconstitutional judicial conduct had been made by the justices.[148]

The developments in the *Hellar* case reveal the difficulties associated with testing the validity of a state reapportionment scheme in light of *Brown*. *Hellar I*[149] was decided by an Idaho Supreme Court that overlooked a previous federal court case holding invalid a provision in the Idaho constitution requiring that districts for the legislature not cross county lines.[150] In *Hellar I*, the trial court ruled that the clause of Idaho's constitution which forbade district lines from crossing county boundaries was "not necessarily" invalidated by the equal protection clause of the fourteenth amendment to the United States Constitution.[151] The Idaho Supreme Court upheld that determination and remanded the case to the trial court to see if the legislative apportionment plan could be defended.[152]

On appeal again to the Idaho Supreme Court, (*Hellar II*),[153] the defendants argued that any plan produced by the state could not meet the criteria of both the United States Constitution and the state constitution. The Idaho Supreme Court refused to accept this argument. Relying on the new law of *Brown v. Thomson*, the court affirmed the lower court's finding of the unconstitutionality of the plan, but suggested in dicta that, based on *Brown*, there was now much greater latitude for states to accommodate their own constitutional restrictions.[154] The court noted that the deviation of population equality accepted in *Brown* involved a deviation of 89% and suggested that even if the plan for Idaho adopted tentatively by the court had a maximum interdistrict population variation of 41%, it would pass constitutional scrutiny under the equal protection clause as interpreted by the latest United States Supreme Court opinion.[155]

The Idaho Supreme Court retained jurisdiction in the case to await pending apportionment legislation. It invited the Idaho legislative body to pass a substitute plan for apportioning the state legislative body but wanted to review the constitutionality of that plan before it became

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[147]*Hellar I*, 104 Idaho 858, 664 P.2d 765 (1983).
[148]*Hellar IV*, 682 P.2d at 559 (Bakes, J., dissenting).
[149]104 Idaho 858, 664 P.2d 765.
[150]*See Hellar II*, 682 P.2d at 536 (Shepard, J., concurring and dissenting).
[151]104 Idaho at 861, 664 P.2d at 768.
[152]*Id.*
[153]682 P.2d 524.
[154]*Id.* at 527.
[155]*Id.*

effective.[156] Working under an extremely short deadline, the legislature passed a plan on March 31, 1984, just before its session came to a close.[157] On April 16, 1984, the court released an order (*Hellar III*)[158] and an opinion (*Hellar IV*)[159] in which it held that the plan passed by the legislature was invalid because, while it preserved the county boundary mandate of the state constitution, it failed to do so in a manner which provided for the least interdistrict population variation.[160] The plan thus failed to satisfy the federal Constitution.[161] The court held that it was not enough that the legislature had passed a plan conforming to the requirements regarding county boundaries and did so within population variations at least comparable to *Brown*; the legislature also had to demonstrate that no other plan having lower interdistrict population variations could have met the Idaho constitutional requirements.[162]

The decisions in *Hellar* are extraordinary in two respects. First, the decisions reveal that, in states with county line apportionment restrictions in the state constitution, the legislature is put into a "no win" situation. Any political decisions made in the statehouse regarding apportionment are sure to be challenged and reviewed by a court. Furthermore, to survive that review, these decisions must frequently be made by striking a delicate balance between the equal protection clause and the state's constitution. This decisionmaking probably cannot be accomplished without failing either the goals of equality or the goals of deference to state constitutions. It is hard to envision a more intrusive court rule than one which professes deference to state legislatures but requires these same legislatures to balance precariously between two constitutions and the state and federal courts. This approach can only result in partial deference or "partial" equality.

Second, the *Hellar* opinions are significant because of the division they created within the Supreme Court of Idaho. Three justices concurred with the majority opinion. One of those, Justice Bistline, however, felt compelled to enter as part of his concurrence a great portion of the record from the hearing in which the constitutionality of the latest legislative reapportionment plan was considered.[163] He attempted to refute the charges by the dissenting justices that the defendants of the proposed plans had been denied the due process guaranteed them by the fourteenth amendment.[164] More astoundingly, Justice Bistline felt compelled to comment upon the nature and tenor of the dissent:

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[156]*Id.* at 529.
[157]*Hellar IV*, 682 P.2d at 546 (Bistline, J., specially concurring).
[158]*Hellar III*, 682 P.2d 538 (Idaho 1984).
[159]682 P.2d 538 (Idaho 1984).
[160]682 P.2d 539 (Idaho 1984).
[161]*Id.*
[162]*Id.*
[163]*Hellar IV*, 682 P.2d 546-59 (Bistline, J., specially concurring).
[164]*Id.*

> [O]ne cannot accept in good grace the tenor and content of the dissenting opinions. Disgruntlement at not prevailing in advocacy ought not to lead to distraction and perversion. A dissenting opinion which is founded in logic and fortified by law would represent another point of view, and surely would be welcomed by bench and bar, the public, and certainly the side who has not prevailed. But where, it may be asked, is the dissenting opinion which portrays the law and logic by which the Court should have held H.B. 746 constitutional?
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> Instead, in what may be observed as pure spleenventing there are two dissenting opinions which for the most part are seen as charging the majority with denying "these defendants the procedural due process guaranteed them by the United States Constitution."[165]

The dissenting opinions in the case were vitriolic in their assessment of what the majority had done. Justice Bakes reviewed what he perceived as purely procedural faults in the manner by which the majority decided that the legislative bill was unconstitutional.[166] He found the procedure and results so upsetting that he ended his opinion with a proposal that the losing side sue the majority for denying them their civil rights.[167] Underneath all his concern one detects a bitterness not often seen in judicial opinions and a hint that the source of Justice Bakes' bitterness was his conviction that the result was wrong.[168]

Justice Shepard, in a separate dissent, focused more on the problem that he perceived had developed when the court forced the legislature to walk the tightrope between the state and federal constitutions and then "insulted" the legislature by ignoring the legislative purposes behind the bill.[169] Justice Shepard's dissent also reflected concern that an earlier federal case[170] which had considered the provision of the Idaho Constitution that required districts to honor county boundaries had been relied upon by the state legislature in constructing its plan.[171] Reversing the legislature after it had relied on that case indicated to Justice Shepard that the legislature had no rules it could use in attempting to pass a constitutional apportionment act.

In addition to the majority opinion, the special concurrence, and the two dissents, Justice Huntley wrote a response to the dissents to refute the charges made against the majority.[172] In particular, he pointed

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[165] *Id.* at 548.
[166] *Id.* at 559 (Bakes, J., dissenting).
[167] *Id.* at 566.
[168] *Id.* at 565. *Cf. id.* at 566 (Shepard, J., dissenting).
[169] *Hellar IV*, 682 P.2d at 567 (Shepard, J., dissenting).
[170] Summers v. Cenarrusa, 342 F. Supp. 288 (D. Idaho 1972).
[171] *Hellar IV*, 682 P.2d at 566 (Shepard, J., dissenting).
[172] *Id.* at 568 (Huntley, J., responding to the dissents).

out that the earlier federal court case had only considered the fact that no plans honoring both the United States Constitution and the state constitution were available.[173] Because the plan sustained by the lower court had accomplished substantital equality of population within the districts and had followed the requirements of the state constitution, Justice Huntley felt the court was justified in not honoring the prior federal cases.[174] Justice Huntley's greatest scorn, however, was for the dissent's suggestion that the losing parties sue the court. He found that comment to be a "disingenuous attempt at intimidation, and might be thought by some to indicate a lack of a modicum of judicial approach and detachment."[175]

Other states have been perplexed by the same question that faced the Idaho Supreme Court in *Hellar*.[176] Generally, the conclusion has been that the state constitutional provisions which mandate nonpopulation bases for distributing representative seats must survive "to the extent possible." As *Hellar* demonstrates, this posture invites political battles in the legislature and divisive and protracted struggles in the courts. Rarely has a state adopted the position that provisions interfering with population-based apportionment must fall automatically,[177] even though this position would have the advantage of removing one source of protracted legislative fights and judicial instrusions into the resolution of those fights.[178]

Given the population deviation of 89% accepted in *Brown*, it now appears that judges have little with which to measure the constitutionality of state apportionment plans and state constitutional provisions. Because the formulated test relies on "to the extent possible" and "only as necessary" language to measure what the federal equal protection clause will permit, it is impossible to predict whether any particular interdistrict population variation will be upheld when challenged; *Brown* removed the only functional and consistently applied rules used to judge what the equal protection clause requires short of absolute equality. What a

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[173]*Id.* at 570.

[174]*Id.*

[175]*Id.* Although the judicial animosity and legislative developments in *Hellar* were undoubtedly extreme, the situation requiring legislatures and courts to walk a tightrope between state and federal constitutions is not. *See infra* note 176 and accompanying text.

[176]*See, e.g.*, Wells v. White, 274 Ark. 197, 623 S.W.2d 187 (1981), *cert. denied*, 456 U.S. 906 (1982); *In re* Reapportionment of Colorado General Assembly, 647 P.2d 191 (Colo. 1982); People *ex rel.* Scott v. Grivett, 50 Ill.2d 156, 277 N.E.2d 881, *cert. denied*, 407 U.S. 921 (1972); Logan v. O'Neill, 187 Conn. 721, 448 A.2d 1306 (1982); Merriam v. Secretary of the Commonwealth, 375 Mass. 246, 376 N.E.2d 838 (1978); Opinion of the Justices, 307 A.2d 198 (Me. 1973); Commonwealth *ex rel.* Specter v. Levin, 293 A.2d 15 (Pa.), *appeal dismissed*, 409 U.S. 810 (1972).

[177]*See supra* note 145.

[178]*See supra* note 176.

judge hearing an apportionment case now knows is only that, while it is clear the state constitution is not to be followed to the letter, some inexplicable and undiscernible figure of interdistrict population variation will be permitted by the federal Constitution even though the Constitution operates on the principle of "one person, one vote."

The result of moving to a "no standard" standard is hard to predict. The absence of a settled rule may result in gross disparities between what is allowed in one state and what is allowed in another. It was, perhaps, this type of difference between what is permitted to citizens of various states that the equal protection clause was designed to prevent. However, it is the language in *Reynolds* that commanded equality, yet suggested preserving state constitutional provisions, that permitted the evolution of doctrines by the Burger Court allowing for this result.

C. Bicameralism

Dicta in *Reynolds* protecting bicameralism at the state level also undermined the rationality of the rules for state legislative reapportionment. The premise of *Reynolds* was that "as a basic constitutional standard, the Equal Protection Clause requires that the seats in both houses of a bicameral state legislature must be apportioned on a population basis."[179] The Court made it clear that analogies to inequalities in the representative basis found in the United States Senate and House of Representatives were inapt in a discussion of state legislatures.[180] The state-created federal government was, in the Court's opinion, entirely dissimilar from the structure of a state government which creates and destroys its subunits at will.[181]

Nevertheless, *Reynolds*' conclusion that "we can perceive no constitutional difference, with respect to the geographical distribution of state legislative representation, between the two houses of a bicameral state legislature"[182] was tempered by another statement that bicameralism was not rendered anachronistic and meaningless when the predominant basis of representation was solely population.[183] In *Reynolds*, the Court suggested various population-neutral ways a state could rationalize continuation of bicameral government once both houses were elected on a population basis.[184] The Court expressly asserted that such population

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[179]377 U.S. at 568.

[180]*Id.* at 571-75.

[181]*Id.* at 576.

[182]*Id.*

[183]*Id.* at 576-77.

[184]*Id.* at 577 (suggesting chamber organization, age requirement, and multi-member districts to distinguish two chambers in a bicameral system even if both were elected on a population basis).

neutral factors were currently in use in states apportioned substantially on a population basis.[185]

The Court's language in these passages shows the Court going out of its way to offer a rational basis for the continuation of state traditions that the passage of time and evolution of American politics have rendered anachronistic. The Court's failure to recognize that American state bicameralism existed as an historical accident is unfortunate.[186] The Court wrote dicta about bicameralism apparently unaware that its words would later be used as a source for deviations from voting equality.[187]

While the equal protection clause does not demand that a state legislature have only one house,[188] the inclusion in *Reynolds* of the bicameralism language[189] suggests that the Court was fortifying the principle of state bicameralism. This indicates that the Court felt obligated to mollify reactions to the *Reynolds* opinion. By offering states a justification for bicameralism, the Court in *Reynolds* provided a future argument that interdistrict population variations to serve bicameral functions are justified. This argument is made possible by the relatively easy substitution of neutrally applied nonpopulation-based differences in the composition of the two houses of a state legislature for the population neutral factors listed in *Reynolds*.

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[185]*Id.*

[186]By describing twentieth century American bicameralism as an "historical accident," it is merely meant that, in terms of political theory, there is no inherent value in a two-chambered legislature that could not be structured into a three or four chambered legislature. Furthermore, the American preference for bicameral governments seems to stem from the historical and economic events which permitted English governmental development into a two chambered body, which was mirrored in the various English colonies.

[187]As early as 1850, astute thinkers had recognized that when both houses of a state government were elected by popular vote the second house was superfluous. Nolan, *Unicameralism and the Indiana Constitutional Convention of 1850*, 26 IND. L. J. 349 (1950). Academic recognition of this fact influenced mainstream politics in the early twentieth century. During this period there were many proposals to establish unicameral state governments. Between 1913 and 1934, there were numerous (forty-six by one count) separate statewide votes on changing state constitutions to provide for unicameral government. *See* Wood-Simons, *Operation of the Bicameral System in Illinois and Wisconsin*, 20 ILL. L. REV. 674 (1926). *See also* Orfield, *The Unicameral Legislature in Nebraska,* 34 MICH. L. REV. 26 (1935); Lancaster, *Nebraska Considers a One-House Legislaure*, 23 NAT. MUN. REV. 373 (1934). *See also* Senning, *Unicameralism Passes Test*, 33 NAT. MUN. REV. 60 (1944). An analysis of votes on these proposals suggests that the tradition of having two houses and opposition of incumbent legislators contributed substantially to the defeat of these proposals, which were more attractive than the votes would imply.

Ultimately, Nebraska became the only state to embrace unicameralism as a result of these proposals, although the theoretical and academic appeal of such proposals is recurring. *See* Note, *Restructuring the Legislature: A Proposal for Unicameralism in Washington*, 51 WASH. L. REV. 901-03 (1976).

[188]*Cf.* Sixty-Seventh Minnesota State Senate v. Beens, 406 U.S. 187 (1972).

[189]377 U.S. 576 ("We do not believe that the concept of bicameralism is rendered anachronistic and meaningless . . . .").

Before *Brown*, the Court commented further on bicameralism. In a per curiam decision in *Sixty-Seventh Minnesota State Senate v. Beens,*[190] the Court, in denying the lower court's power to require large scale changes in a state legislature to achieve equality, said, "If a change of that extent were acceptable, so, too, would be a federal court's cutting or increasing size by seventy-five percent or ninety percent or, indeed, by prescribing a unicameral legislature for a state that has always followed bicameral precedent."[191] The implication here was that bicameralism, if selected by a state, was untouchable by a court acting to administer the equal protection clause.

Once it was clear that unicameralism was an impermissible remedy for apportionment violations, it was only a short step to a determination that nonpopulation bases for apportionment could be used to achieve different compositions in the two houses of a state legislature so long as an equal protection minimum was met. Accordingly, where a state's constitution required that counties be treated as a basis for distinguishing the two legislative chambers, it was permissible under the federal Constitution to deviate from equality to accommodate this state bicameralism.

After *Mahan* permitted this result, it seemed understood that accommodation of nonpopulation-based apportionment to sustain bicameral theory would end where population variations exceeded 16%.[192] This understanding was taken away by the Court's action in *Brown*. The opinion in *Brown* began with a statement that Wyoming had had a bicameral legislature since its statehood in 1890.[193] This is significant because it shows the Court was impressed with the longevity of the bicameral form of government that required the county-based apportionment plan. The Court then reviewed apportionment litigation in Wyoming[194] and found that the apportionment of the Wyoming house of representatives had been sustained in 1964 and again in 1972.[195]

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[190]406 U.S. 187.

[191]*Id.* at 199.

[192]*See supra* text accompanying note 122.

[193]462 U.S. at 837.

[194]*Id.* at 837-38.

[195]The *Brown* Court overlooked the language in the 1964 case which said, "It is not seriously contended, however, that this disparity [in the population of house of representative districts] creates an invidious discrimination or violation of the equal protection clause of the Fourteenth Amendment . . . . The principal thrust of plaintiff's complaint and argument is directed at the reapportionment provisions of the statute as they apply to the senate." Schaefer v. Thomson, 240 F. Supp. 247, 251 (D. Wyo. 1964), *supplemented*, 251 F. Supp. 450 (1965), *aff'd sub nom.*, Harrison v. Schaefer, 383 U.S. 269 (1966). Thus, the Wyoming house of representatives apportionment was originally approved in a case where it was never really litigated.

In 1972, the district court reviewing the 1971 Reapportionment Act in Wyoming relied on the earlier approval of the house of representatives in the 1964 case to dismiss the apportionment challenge offered then because "the 1963 reapportionment of the House

Disparate treatment along bicameral lines, however, surfaced early in this reapportionment litigation. The *Brown* Court footnoted this dichotomy and indicated only that "[t]he Wyoming House of Representatives presents a different case because the number of representatives is substantially larger than the number of counties."[196] Under the Court's rationale, differences in structure of the two houses in a state legislature justify use of a nonpopulation basis for apportioning one of these houses. Because so many states have one house "substantially larger" than the other, the rationale of *Brown* could be used elsewhere to satisfy bicameralism at the expense of equality.

Other indications that the *Brown* Court was accommodating the bicameral structure of the Wyoming legislature appeared in the Court's continuing references to Wyoming's policy of "preserving county boundaries."[197] The Court failed to recognize expressly that the state's policy was not to "preserve county boundaries," but to preserve one chamber in which every county was represented. If the state were only interested in preserving county boundaries, it could easily combine small population counties. Instead, the state's goal was to serve a particular theory of bicameralism — to have every county represented.

The Court hinted, however, that it understood there was a difference between "preserving county" representation and using counties as representational units in only a few places. For example, the Court stated that "there also can be no question that Wyoming's Constitutional policy — followed since statehood — of using counties as representative districts and ensuring that each county has one representative is supported by substantial and legitimate concerns."[198] Later, the Court referred to the state's efforts to ensure that the voters of Niobrara County would have their own representative.[199] These statements hint that the Court was well aware that the state needed permission to use counties for representation in one house of a bicameral state legislature; *Brown* gave that permission.

Although not expressly admitted by the court, *Brown* permitted gross deviations from voter equality to accommodate the nonpopulation-based apportionment necessary to sustain the state's bicameralism. The evo-

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was not substantially altered . . . ." Thompson v. Thomson, 344 F. Supp. 1378, 1380 (D. Wyo. 1972). Again, the merits of the challenge were not examined. Thus, when the *Brown* Court cited this approval of the apportionment scheme of the Wyoming house of representatives, it repeated a tradition of avoiding a substantive look at what the house apportionment in Wyoming actually did to voting equality. More importantly, the Court simultaneously noted the different treatment given apportionment for the Wyoming Senate. It had been declared unconstitutional in 1964. *Schaefer*, 240 F. Supp. at 253.

[196]467 U.S. at 845.

[197]*Id.* at 843, 847.

[198]*Id.* at 842.

[199]*Id.* at 848.

lution from suggestion of population neutral criteria in *Reynolds* to the approval of nonpopulation criteria applied neutrally in *Brown* exchanges equality for deference to bicameralism. Because *Brown* permits bicameralism to serve as the source of voting power inequalities, it comes close to recognizing as valid the analogy of state governmental structure to the federal governmental structure. This analogy had been expressly rejected in *Reynolds*.[200] After *Brown*, states with constitutions similar to Wyoming's may have permission to use political units as representational units in one chamber of a two-chambered legislature. Thus, the Court, while pledging fealty to *Reynolds*, eviscerated *Reynolds*' basic commitment to a primarily population-based apportionment requirement.

Language in *Reynolds* indicating the weakness of bicameralism after *Reynolds* could have offered movement toward the equality envisioned there. Such dicta would perhaps have prompted greater discussion of the theories of bicameralism and potentially assisted the states' movement toward unicameralism. If a state saw that equal voting power renders a second chamber superfluous, it might not attempt to justify a second chamber by creating nonpopulation-based apportionment plans for that chamber. Instead, the dicta of *Reynolds* bolstering bicameralism has permitted an evolution away from the equality demanded there. Hence, when faced with an apportionment case in a state like Wyoming, a judge is torn between the "spirit" of *Reynolds* and the conflicting lessons of its progeny. A judge or legislator in such a case has no real measure of the reach of the equal protection clause.

To remedy this problem, the Court has three options. First, it could simply say that a state is free to organize one chamber of a bicameral house on a nonpopulation basis. This rule, however, would be flatly contrary to *Reynolds* and alien to the equality commanded by the fourteenth amendment. Second, the Court could establish firm guidelines on how far from equality a state can go in experimenting with bicameral theories. This approach, however, seems to have been precluded by *Brown's* rejection of the reliable 16% maximum variation without offering any new fixed level of permissible variation. The only remaining approach is for the Court to recognize that *Reynolds* was primarily concerned with equality. If the Court recognizes that the equal protection clause preempts all state laws to the contrary, then the number of chambers a state has is absolutely irrelevant to the federal court's application of the equal protection clause. This third approach would simply require a state, no matter how many chambers it has, to apportion them on a population basis. Once a state has satisfied the federal goal of equal protection, it could then organize its various chambers on whatever population neutral criteria it liked. Until such a simple and easily applied

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[200]377 U.S. at 573.

rule is adopted, the bicameralism language in *Reynolds* will continue to cause contention in apportionment cases.

D. Theories of Representation

In *Baker v. Carr*,[201] Justice Frankfurter in dissent made an observation that led to much criticism of the majority's action. He commented that the nature of reapportionment cases required selection between competing theories of representation.[202] To the extent that is true, the majority in *Reynolds* made clear its conception of what the Constitution, as amended, required in the way of representation: "Legislators represent people, not trees or acres."[203] Like the earlier pronouncement of the one person, one vote requirement, this statement meant that a democracy's commitment to equality dictated its legitimate representational theories. Thus, the Constitution envisioned representation of individual people as individuals, not as interest groups. A population-based representation scheme was the only way to satisfy both the goal of equality and the democratic ideals of American constitutionalism.[204]

In *Reynolds*, the Court established that equality of representation was the primary goal in selecting a theory of representation. Only through this equality could a citizen achieve "full and effective participation" in the government of his or her state. The mechanism to reach the primary goal of *Reynolds* was equal voting power achieved through population-based apportionment. However, just as there was a post-*Reynolds* evolution away from strict demands for equality of population-based representative districts, there was a movement away from the goal of equality of representation. This tendency was facilitated by the Court permitting states to use *de minimus* variations without review and to justify substantial population deviations by state policies accommodating nonpopulation-based theories of representation. In *Brown*, the Court approved a maximum interdistrict population variation far beyond any previous limit and used language indicating that it had misunderstood or forgotten the goal of representational theory articulated in *Reynolds*.

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[201]369 U.S. 186.

[202]*Id.* at 299-300 (Frankfurter, J., dissenting).

[203]377 U.S. at 562.

[204]In describing the Constitution's requirements, the *Reynolds* Court said:

> [R]epresentative government is in essence self-government through the medium of elected representatives of the people, and each and every citizen has an inalienable right to full and effective participation in the political processes of his State's legislative bodies. Most citizens can achieve this participation only as qualified voters through the election of legislators to represent them. Full and effective participation by all citizens in state government requires, therefore, that each citizen have an equally effective voice in the election of members of his state legislature. Modern and viable state government needs, and the Constitution demands, no less.

377 U.S. at 565.

Some of the Court's curious language in *Brown* about representation was derived from the trial court which apparently neither understood the permissible type of representation under *Reynolds* nor attempted to compare Wyoming's theory of representation to the *Reynolds* model. The lower court's misunderstanding is exemplified in the following passage:

> Wyoming as a state is unique among her sister states. A small population is encompassed by a large area. Counties have always been a major form of government in the State. Each county has its own special economic and social needs. The needs of the people are different and distinctive. Given the fact that the representative from the combined counties of Niobrara and Goshen would probably come from the larger county, i.e. Goshen, the interests of the people of Niobrara County would be virtually unprotected. . . . Under the facts of this action, to deny these people their own representative borders on abridging their right to be represented in the determination of their futures. . . . Without representation of their own in the State House of Representatives, the people of Niobrara County could well be forgotten.[205]

The failure of the Supreme Court to recognize what the lower court was doing in *Brown* is striking. The district court's language indicates that it considered a proper model of representation to be representing counties, not people. The underlying premise of *Reynolds*, however, was that state representatives represent people, not trees or acres.[206]

Because the trial court in *Brown* started from the presumption that representation of counties was proper, the conclusion it reached is not surprising. At least three of the Supreme Court Justices considering the cases apparently found such representation proper.[207] Although the Court noted that "[e]ven a neutral and consistently applied criterion such as

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[205]Brown v. Thomson, 536 F. Supp. 780, 784 (D. Wyo. 1982), *aff'd on appeal*, 462 U.S. 835 (1983). The concurrence of Judge Doyle reflected this same sort of thinking:

> If a representative had been taken from one of the other counties in order to give Niobrara one, it would be a different matter. . . . [I]nasmuch as the Legislature created a new additional representative, rather than taking away one or more, the result was a total of 64 rather than 63. As a result of this, no county suffered, and no one can claim that he or she was injured. . . . Every other county comes very close to fair and equitable representation.

536 F.Supp. at 786 (Doyle, J., concurring). Later he displayed his lack of understanding of the representational goal of *Reynolds* by saying that "every county can be represented in the legislature." *Id.*

[206]377 U.S. at 562.

[207]*Brown*, 462 U.S. 835 (Burger, C. J., Powell, J., and Rehnquist, J., joining the Court's opinion without limitation as suggested in the concurrence of Justice O'Connor and Justice Stevens).

use of counties as representative districts can frustrate *Reynold's* [sic] mandate. . . ,"[208] the Court later in the opinion appeared to suggest that there is a proper role for using counties as a representational basis. "There can also be no question that Wyoming's constitutional policy — followed since statehood. . . ensuring that each county has one representative is supported by substantial and legitimate state concerns."[209] Later the Court approved the lower court's reasoning by stating that "the effect of the 63-member plan would be to deprive the voters of Niobrara County of their own representative, even though the remainder of the House of Representatives would be constituted so as to facilitate representation of the interests of each county."[210]

This dicta brings the majority's understanding of its own statements into question. If the Court really meant to endorse the idea of representation of counties rather than people, it appears that a fragile majority of the Court is attracted by nonpopulation-based theories of representation. Were the Court to recognize officially in a subsequent case that county "interests" are a legitimate basis for representation, it would contradict the *Reynolds* statement that legislators represent people and not trees. Until these possible contradictions are clarified, the *Brown* Court has raised another obstacle to resolution of state legislative apportionment cases. Group interest representation was supported by the *Brown* Court's dicta without any recognition that such support would require overruling part of *Reynolds*. As a result, lower courts were given the Sisyphean task of applying the Court's dicta in *Brown* while honoring the contradictory instruction of *Reynolds*.[211]

E. Political Subunits

Even divorced from the theory of representation of subunits rather than people, the evolution from *Reynolds* to *Brown* has blurred the significance of a state's interest in preserving the integrity of political divisions. *Reynolds* did indicate that "[a] State may legitimately desire to construct districts along political subdivision lines to deter the possibilities of gerrymandering."[212] Although the Court later implies that a state might have a clearly rational scheme to give some legislative representation to political subdivisions, nothing in the Court's opinion connects this rational state policy to a legitimate state desire other than that of using population as basis for representation.

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[208] *Id.* at 845.

[209] *Id.* at 843.

[210] *Id.* at 848.

[211] *See Hellar II*, 682 P.2d 524 (Shepard, J., concurring and dissenting) (*Brown* "simply can not be reconciled with previous opinions of the Court unless *Reynolds v. Sims* and its progeny are overruled, but we are told that those cases still are the foundation of legislative apportionment.").

[212] 377 U.S. at 581.

Given the language in *Reynolds* that citizens vote, not trees or acres, it may well be that the Court could not conceive of a legitimate basis for such a state policy other than to prevent gerrymandering. Thus, any attempt to provide representation on the basis of political subdivisions that is not an attempt to avoid gerrymandering may be suspect under a strict reading of *Reynolds*. Additionally, it must be remembered that *Reynolds* also recognized the inappropriateness of comparing state legislative schemes with the federal governmental structure.[213]

After *Reynolds*, the Court had opportunities to reevaluate the extent to which states could justify deviations from equality by claiming respect for political subdivision. The same day *Reynolds* was decided, *WMCA, Inc. v. Lomenzo*[214] reversed a lower court decision that had found the county was a classic unit of governmental organization and administration in Delaware and that allocation of representatives on county lines was therefore acceptable.[215] In *WMCA, Inc.*, the Court found that even an historical element of sovereignty residing in Delaware's county governments did not permit use of the federal analogy to distribute representatives to the counties as counties.[216]

In another case decided the same day as *Reynolds*, the Court established a test clarifying the extent to which deviations, including those for political subunits, would be acceptable. In *Roman v. Sincock*,[217] a challenge to a Maryland apportionment scheme which used counties as districts, the Court indicated that deviations based on state constitutional grounds were not sustainable:

> [T]he proper judicial approach is to ascertain, whether, under the particular circumstance existing in the individual state whose legislative apportionment is at issue, there has been a faithful adherence to a plan of population based representation, with such minor deviations only as may occur in recognizing certain factors that are free from any taint of arbitrariness and discrimination.[218]

The Court in *Roman* articulated this standard even though Justice Powell in *Brown* later asserted that "[t]here can be no question that Wyoming's constitutional policy — followed since statehood — of using counties as representative districts and ensuring that each county has one representative is supported by substantial and legitimate state concerns."[219] Justice Stewart had been required to make that same claim in dissent

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[213]See *supra* note 180 and accompanying text.
[214]377 U.S. 633 (1964).
[215]*Id.* at 640.
[216]*Id.*
[217]Roman v. Sincock, 377 U.S. 695 (1964).
[218]*Id.* at 710.
[219]462 U.S. at 843.

in *Lucas v. Forty-Fourth General Assembly of Colorado*.[220] Stewart complained that a scheme which denied a county a representative would leave the county unrepresented.[221] This complaint was accepted by the lower court[222] and affirmed by the Supreme Court in *Brown*.[223]

The practice of using counties as units after 1964 was largely shaped by *Kirkpatrick v. Prisler*,[224] later recognized as the seminal case involving congressional districting. At the time it was decided, *Kirkpatrick* simply concerned the legitimacy of various size deviations from population equality in a state districting scheme.[225] The Court in *Kirkpatrick* explicitly rejected claims that honoring political subdivision boundaries was a legitimate reason for the deviations that appeared in the plan before the Court:

> We do not find legally acceptable the argument that variances are justified if they necessarily result from a state's attempt to avoid fragmenting political subdivisions by drawing congressional district lines along existing county, municipal, or other political subdivision boundaries. The state interest in constructing congressional districts in this manner, it is suggested, is to minimize the opportunities for political gerrymandering, but an argument that deviations from equality are justified in order to inhibit legislators from engaging in partisan gerrymandering is no more than a variant of the argument, already rejected, that considerations of practical politics can justify population disparities.[226]

Thus, although *Kirkpatrick* involved congressional apportionment, the Court appeared to place a minimal value on plans to honor political subdivision lines in districting. Additionally, if the goal of inhibiting gerrymandering by use of counties as districts could not save such a plan, it is doubtful the Court would have been willing to accept other bases, such as history or aesthetics.

Reynolds envisioned essentially a population-based scheme adjusted to accommodate boundaries where possible for convenience. After 1971, it appears that the Court began to reverse this theory — i.e., after 1971 a state could apportion by county and deviate from that only where necessary to achieve "substantial" population equality. The difference between the two approaches is that one approach starts with a premise of equality and permits exceptions, while the other approach starts with

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[220]377 U.S. 713, 762 (1964) (Stewart, J., dissenting).
[221]*Id.* at 762 (Stewart, J., dissenting).
[222]536 F. Supp. 780, 784 (1982).
[223]462 U.S. at 848.
[224]394 U.S. 526 (1969).
[225]*Id.*
[226]*Id.* at 533.

a premise of inequality and deviates from that inequality solely to reach the minimum equality required by the federal Constitution.

Prior to *Kirkpatrick*, the Court in *Kilgarlin v. Hill*[227] considered Texas' reapportionment plans and demanded that sustained deviations had to be the least possible given the planned goal of honoring county lines. In *Kilgarlin* the Court reversed a lower court which had accepted variations of considerable size in Texas' redistricting attempt without requiring that Texas demonstrate that the goal of respecting county lines required the deviations.[228] It would appear that under this approach, lower courts would be encouraged to use only a population basis for reapportionment, although county boundaries could be used as a convenient tool for drawing lines.

In 1971, the Court's holding in *Abate v. Mundt*[229] indicated that political subdivisions might be a permissible source of population variation. Despite *Kirkpatrick's* language, the Court accepted the state's desire to preserve the integrity of political subdivisions as a justification for an apportionment plan which departed from numerical equality.[230] The Court justified this result by noting that counties usually included fewer people than congressional districts.[231] Therefore, some deviation in state districting could be allowed solely because the legislature was attempting to honor political subdivsion lines — usually counties.

The *Abate* holding was not the product of earlier decisions, however. The dissent stressed that *Reynolds* and *Kirkpatrick* required a good faith effort to achieve absolute equality.[232] For the dissent, good faith meant more than merely juggling existing geographical units to arrive at some semblance of equality; it stressed that good faith could never be demonstrated where the legislature relied solely on county lines to draw boundaries for the districts.[233]

The extent to which the *Abate* ruling altered the orientation of the Court on the permissibility of using political subunits as an excuse to deviate from equality was demonstrated in *Mahan v. Howell*.[234] In *Mahan*, a Virginia apportionment plan was challenged. The plan had substantial population variations among districts created by adhering to county lines.[235] This apportionment structure existed even though the state constitution had recently been amended to remove the prohibition against crossing county lines in districting.[236]

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[227]386 U.S. 120 (1967).
[228]*Id.*
[229]403 U.S. 182 (1971).
[230]*Id.*
[231]*Id.*
[232]*Id.* at 188 (Brennan, J., dissenting).
[233]*Id.*
[234]410 U.S. 315 (1972).
[235]*Id.* at 319.
[236]*Id.* at 317.

In addition to determining whether *Kirkpatrick* controlled state apportionment cases, the Court in *Mahan* had to decide whether the district court was correct in invalidating the plan on the basis that using county lines was unnecessary under the new constitution and created unnecessary population variations.[237] The Supreme Court, in reversing the district court, found that the legislature's wish to preserve county lines, which was no longer based on a constitutional directive, was sufficient to justify the substantial population variations in the plan.[238] Thus, the mere assertion of a state policy of preserving state districts could justify a deviation of up to 16.4%.

Although the 16.4% figure might be the limit of acceptable variation,[239] it was clear that the Court no longer bound itself by the rules applied in congressional cases or by the dicta in *Reynolds* requiring population equality first and other considerations second in state apportionment cases.[240] After *Mahan*, a state's goal of population equality between districts was apparently on equal footing with other state policies. This result promotes judicial and legislative confusion and adds to the problems in state legislative apportionment cases. By denying the absolute primacy of the goal of equality, the Court has done nothing to press states to honor the *Reynolds* goal of voting power equality; nor has the Court provided a workable means of balancing equality with the competing state goals of preserving political subunits.

F. Political Subgroups

The politics of apportionment frequently result in a dominant political party maximizing the voting strength of identifiable political subgroups. These efforts touch the basic representational theory question of whether legislators are to represent interests or individuals. The Court in *Reynolds* answered this question.[241] Subsequently, however, apportionment plans have been successfully defended despite interdistrict population disparities created to favor a particular party. For example, in *Gaffney v. Cummings*,[242] the district court found that the challenged plan was the product of an explicit attempt to divide the state into "safe seats" for the two parties.[243] On appeal, the Supreme Court ignored the language from *Reynolds* and found that because legislative passage of reapportioning bills is always

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[237]*Mahan*, 410 U.S. at 320-21, 325.

[238]*Id.* at 327.

[239]*Id.* at 329.

[240]377 U.S. at 562.

[241]*Id.* at 568. The Court stated that "neither history alone, nor economic or other sorts of group interests, are permissible factors in attempting to justify disparities from population based representation." *Id.* at 579-80.

[242]412 U.S. 735 (1973).

[243]*Id.* at 753.

a political process, political consequences neither were, nor could be, barred from the apportioning process.[244] Therefore, it reversed the lower court's determination that the state's goal was unconstitutional. Apparently, interdistrict population disparties were tolerable to the limited extent envisioned by the *Gaffney* Court to further the dominant political party's interests.

Another feature of apportionment plans designed to aid political groups is that each such plan is designed to minimize the voting power of some disfavored minority. When this damaging aspect of such apportionment plans has been challenged, courts have given conflicting results. In *Burns v. Richardson*,[246] a case decided in 1966, the Court reversed a lower court's orders that eliminated multi-member senatorial apportionment for the Hawaii legislature. The Court found that invidious discrimination could not be shown merely through the use of multi-member districts; such discrimination must appear through evidence in the record that "under the circumstances of a particular case" a multi-member district was designed for or otherwise resulted in minimizing or cancelling out the voting strength of racial or political voters.[247] The Court found no such evidence.[248]

Later, the Court also insisted that a demonstration of intent and actual effect be proven before a scheme would be found defective for diluting the voting strength of a particular group.[249] Nevertheless, the obvious implication of such holdings is that, although the burden of proof is high, it is unconstitutional to minimize intentionally voting power of political minorities through an apportionment scheme.

A contrary statement by the Court surfaced in *Whitcomb v. Chavis*.[250] In *Whitcomb,* the Court was asked to sustain a lower court finding that the effect of multi-member districting in Marion County, Indiana, unconstitutionally minimized the voting strength of black voters.[251] The Court refused to agree with this claim, stating that "[t]he voting power of ghetto residents may have been cancelled out as the District Court held, but this seems a mere euphemism for political defeat at the polls."[252] According to this approach, minority groups are destined to have their influence minimized through the natural functioning of the political process, and the equal protection clause does not operate to prevent

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[244]*Id.* at 754.

[245]*Id.* at 753. The Court stated that states are not required to use a "politically mindless approach." *Id.*

[246]384 U.S. 73.

[247]*Id.* at 88.

[248]*Id.* at 87, 98.

[249]*See, e.g.*, Mobile v. Bolden, 446 U.S. 55 (1980).

[250]403 U.S. 124 (1971).

[251]*Id.*

[252]*Id.* at 153.

this result.[253] This theory mirrored the reasoning in *Gaffney* that it was not unconstitutional to create interdistrict population inequalities to further political subgroups.

The problem was that such a theory collided with the theory arising from *Burns*. Therefore, even prior to *Brown*, signals sent to lower courts on the constitutionality of using political subgroups to rationalize interdistrict population inequalities were mixed; *Gaffney* and *Whitcomb* seemed to accept either helping or hurting political subgroups through the apportionment process. In contrast, the other post-*Reynolds* cases, such as *Kirkpatrick*, expressly stated that "to accept population variances, large or small, in order to create districts with specific interest orientation is antithetical to the basic premise of the constitutional command to provide equal representation for equal numbers of people."[254]

Although confusing, the discord between *Kirkpatrick* and *Whitcomb* is not entirely inexplicable. After 1967 a more favorable climate might have existed for reviewing political subgroup-oriented apportionment. The Voting Rights Act of 1967[255] spawned its own reapportionment litigation, and this litigation inevitably intertwined with purely constitutionally-based challenges to apportionment plans. By attempting to improve and facilitate the participation of all races in the voting process, the Act encouraged court challenges to schemes having the effect of denying black voters equally effective votes and representation. The remedies offered by the Act occasionally have the effect of reversing past prejudice so that redistricting schemes must attempt to maximize the voting strength of the black citizens within the districts.[256] Such benign discrimination has been held to be constitutional, but would technically violate the language of *Reynolds*. The passage and application of the Voting Rights Act may well have contributed to the confusion of the Court's pronouncements in *Gaffney* and *Whitcomb*.

The Voting Rights Act may also have provided a basis for the Court to find a "rational state policy" in a state's use of political subgroups. By doing so, the state would bring its apportionment plan within the *Mahan* guidelines. *Mahan* had recognized that an interdistrict population variation of up to 16% was acceptable when premised on a rational state policy serving a legitimate state end. Because the Voting Rights Act mandated consideration of some political subgroups, it may have become easy to think that a state could always consider political subgroups and use them as the basis for a "rational state policy."[257]

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[253] *Id.*

[254] 394 U.S. at 533.

[255] Voting Rights Act of 1965, 42 U.S.C. § 1973.

[256] *See* Major v. Treen, 574 F. Supp. 325 (E.D. La. 1983). *But see* Marshall v. Edwards, 582 F. 2d 927 (5th Cir. 1978).

[257] *Mahan*, 410 U.S. at 325 (quoting Reynolds v. Sims, 377 U.S. at 579).

After 1971, the Supreme Court had precedent allowing political subgroups to be used as the basis of interdistrict population inequalities. It also had precedent disallowing such apportionment. Even with that conflict, the Court was limited in permitting such deviation. The confusion was made tolerable by the workable *Mahan* 16% standard. *Brown*, however, destroyed the measure used by courts and legislatures. *Brown's* invitation to deviations greater than 16% will result in the need to scrutinize every challenged apportionment plan to see exactly what the legislative motivation was. This encouragement of litigation does not seem to serve any judicial purpose.

The easiest resolution of this problem has been articulated and has been the common sense resolution all along. As a Tennessee judge has noted, the function of "drawing legislative district lines" must be blind to "race, color, religion, ethnicity, political persuasion, economic condition, or the like or incumbencies."[258]

The adoption of this position would assure that both equality and fairness are served. A majority could rule as the majority, but it could not apportion to perpetuate itself. The Court overlooked this solution when it found in *Gaffney* that any requirement that political parties not be the basis for the districting of a state could result in "the most grossly gerrymandered results."[259] In *Gaffney*, the Court ignored the fact that *Reynolds* had expressly disapproved of group-conscious districting and had given assurances that the Constitution forbade simple as well as clever schemes for disenfranchising voters.[260] Had the Court considered that principle of *Reynolds*, it would have recognized that protection from gerrymandering could be accomplished without sacrificing the goal of purely population-based apportionment.[261]

Excluding some potential difficulties with the Voting Rights Act,[262]

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[258]*Lockert v. Crowell*, 656 S.W.2d at 845 (Brock, J., concurring and dissenting).

[259]412 U.S. at 753.

[260]377 U.S. at 563.

[261]See *Karcher*, 462 U.S. 749-50 (Stevens, J., concurring).

[262]A strict equality rule poses problems under the Voting Rights Act because it would require invalidating salutary attempts under the Act to remedy past inequities by racial-conscious apportionment. Such apportionment raises substantial theoretical difficulties anyway, however. For example, it is impossible to ascertain which districting scheme is best for a particular group. A particular minority group representing 34% of the population might be grouped into one district or spread among three districts equally. If the group were in one district, it could easily elect "its" representative. If the group were dispersed into three separate districts, it would be possible for the minority to be the decisive factor in the election of three officials.

These difficult problems suggest that the Voting Rights Act and its remedies should be treated as a wholly different body of law from apportionment under the *Reynolds* formulation. If it is agreed that the special remedial powers granted Congress in the fifteenth amendment permit use of the powers in the Voting Rights Act, then it is appropriate to preserve for purely equal protection analysis the strict equality rule proposed here.

it seems that the best way to avoid the difficulties and confusion created by *Brown's* allowance of interdistrict population deviations to accommodate political subgroups to an non-defined extent is a strict population-based apportionment rule. Bold, inflexible equality of voting power would better fulfill the promise of *Reynolds* and avoid the unmanageable quagmire created by the conflicting theories of *Kirkpatrick*, *Whitcomb*, and *Brown*.

G. History and Geography

In the same passage that condemns group interest representation in *Reynolds*, the Court announced that "neither history alone, nor economic or other sorts of group interests are permissible factors."[263] The Court explained that the historical reasons for limiting districts to areas easily reached and covered by travel simply do not make sense in a modern, interconnected, telecommunicating world.[264] That conclusion was reached in 1964.

Twenty years later, the Court was embracing the factors rejected in *Reynolds* as the basis for accepting the largest deviation from equality ever accepted by the Court.[265] In *Brown*, Justice Powell recognized that the state would have to justify the substantial deviation from population equality.[266] He accepted four reasons for the deviation. First, Wyoming had applied this factor "in a manner free from any taint of arbitrariness or discrimination."[267] This conclusion was reached by a demonstration that the state had been following the practice for decades, consistently throughout the state.[268] Second, the Court accepted a claim that the state policy was particularly important because of the state's conditions.[269] Specifically, the Court relied on the trial court's finding that "Wyoming as a state is unique among her sister states. A small population is encompassed by a large area. Counties have always been a major form of government in the state. Each county has its own special and social needs. The needs of the people are different and distinctive."[270] Third, the Court accepted a showing that the deviation went no further than necessary to preserve the state's policy.[271] Last, the Court concluded that there was no built-in bias in the apportionment plan.[272]

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[263]377 U.S. at 579-80.

[264]*Id.* at 580.

[265]*See supra* note 97 and accompanying text.

[266]462 U.S. at 842-43.

[267]*Id.* at 843 (quoting Roman v. Sincock, 377 U.S. 695, 710 (1964)).

[268]*Id.*

[269]*Id.* at 843-44.

[270]*Id.* at 851 n.5 (quoting *Brown*, 536 F. Supp. at 784).

[271]*Id.* at 841.

[272]*Id.* at 844.

Each of these conclusions was based on a premise rejected by *Reynolds*. First, following *Reynolds*, it could not be contended that population inequalities do not discriminate. Every deviation from population equality dilutes the vote of some individual.[273] Second, the decision to select counties as the basis for representation could hardly be more arbitrary. The development and creation of counties is nearly always an historical accident; county boundaries are determined by political needs, property lines, and geographical anomalies.[274] Furthermore, the basis for the conclusion that county boundaries were not arbitrary was simply that the state had proceeded under this plan for decades, and *Reynolds* had expressly said that history alone cannot justify population disparities.[275] Moreover, *Reynolds* had expressly noted that sparseness of population and large-area districts did not justify population disparities.[276] Given the immense advances in both communications and modes of travel since 1964, it is inconceivable that the districts invalidated despite claims of sparseness of population and area in 1964 could be acceptable today.

Powell's third contention, that the plan went no further than necessary to satisfy the state's policy, is contradicted by the state's own action in preparing a plan that would have suited the legislature if the plan permitting such a substantial population variation had been found unconstitutional.[277] As Justice Brennan asserted in the dissent, the question is whether another plan serving the same policy could do so substantially as well.[278] Given that the incremental effect of the Niobrara County representative was minimal, it would seem that the presence of that representative was not a substantial factor to the legislature. Thus, the alternative plan, which would have had a lower overall population deviation, would have served substantially as well.

Justice Powell's fourth justification for the Wyoming plan overlooked the fact that any scheme based on an award of a representative for every county has the built-in bias of favoring rural voters over urban voters.[279] Therefore, Justice Powell's claim that the plan favors no particular group is unconvincing.

Both concurring Justices in *Brown* agreed with the majority that the longstanding policy of treating counties as representative districts

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[273]377 U.S. at 562-63.

[274]*See* Averbach, *The Reapportionment Cases, One person, One Vote — One Vote, One Value*, 1964 S. Ct. Rev. 1, 39.

[275]377 U.S. at 579-80.

[276]*Id.* at 580. *See also* Chapman v. Meier, 420 U.S. 1, 24-25 (1975).

[277]*Brown*, 462 U.S. at 841.

[278]*Id.* at 852 (Brennan, J. dissenting).

[279]Durfee, *Apportionment of Representation in the Legislature: A Study of State Constitutions*, 43 Mich. L. Rev. 1091, 1096 (1945).

was a factor for deciding that the scheme was constitutional.[280] This seems odd in the face of *Reynolds* language absolutely rejecting history and geography as bases for justifying inequality.[281] Furthermore, these bases had been rejected in other cases as well. For example, the court in *Butterworth v. Dempsey*[282] found that *Reynolds* meant that the "Equal Protection Clause is not concerned with desires to perpetuate political philosophies, geographical entities, or historical anomalies.[283] Similarly, in striking down the Colorado apportionment plan in *Lucas v. Forty-fourth Colorado General Assembly*,[284] the Court indicated that just because a plan rationally considers geographic, historic, topographic, and economic interests does not provide an adequate justification for substantial disparity from population-based representation.[285] Even some years later in *Kirkpatrick* and *Swann v. Adams*,[286] the Court reemphasized that geography was an unacceptable basis for variation in population between districts.[287]

Although the Court in *Abate v. Mundt*[288] was prepared to recognize some justifiable deviations from equality, geographical or political interests were not expressly listed as available justifications.[289] The Court recognized for the first time, however, that historical factors may support a particular scheme.[290] Justice Brennan in dissent expressed his displeasure with such a deviation from the original *Reynolds* formulation when he stated: "It is not clear to me why such a history, no matter how protracted, should alter the constitutional command to make a good-faith effort to achieve equality of voting power as near to mathematical exactness as is possible."[291]

When the Court accepted the distinction between the congressional and legislative apportionment cases in *Mahan v. Howell*,[292] it accepted an argument similar to that later advanced by Wyoming in *Brown*.[293] As Justice Brennan set forth in his *Mahan* dissent, however, the state's claim that the deviations were permissible because of the state's unique situation was disingenuous: "Every apportionment case presents a unique combination."[294]

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[280]462 U.S. at 849 (O'Connor, J., Stevens, J. concurring).
[281]377 U.S. at 579-80.
[282]229 F. Supp. 754 (D. Conn. 1964).
[283]*Id.* at 763.
[284]377 U.S. 713.
[285]*Id.* at 738.
[286]385 U.S. at 447.
[287]394 U.S. at 536.
[288]403 U.S. 182.
[289]*Id.* at 185.
[290]*Id.*
[291]*Id.* at 189 (Brennan, J., dissenting).
[292]410 U.S. 315.
[293]*See Brown*, 462 U.S. at 841 n.5, 843.
[294]*Mahan*, 410 U.S. at 334 (Brennan, J., dissenting). Justice Brennan's statements on

Even with *Mahan*'s language, the Court as late as 1977 still accepted most of the *Reynolds* position on geography, topography, and history. In *Chapman v. Meier*,[295] the Court took great pains to assert that "sparse population is not a legitimate basis for a departure from the goal of equality."[296] And in 1977, the Court found that a historical policy against fragmenting counties was insufficient to overcome the strong preference for single-member districts.[297]

By 1983, however, Justice Brennan, writing in *Karcher*, included in his list of considerations which may justify population deviations in congressional districting the goal of "preserving the cores of prior districts."[298] This goal would seem to be predicated on an historical consideration declared unacceptable in his prior opinions. His position in *Karcher* suggests that he, along with the other Justices, was prepared in 1983 to recognize more the controlling hand of history in permitting some deviation from equality in apportionment cases. He would not, however, embrace the extent to which the economic, geographic, and demographic features unique to Wyoming were accepted by the lower court and the Supreme Court.[299] What he feared, that the temptation will be too great for legislatures to justify otherwise unacceptable population deviations on the uniqueness of their situation, were the same fears leading the *Reynolds* Court to reject history as a basis for inequality. *Brown* increased the possibility that these fears will be realized and diminished the clarity of *Reynolds*' original commitment to equality.

H. Incumbency

Some legislatures, in passing apportionment plans, have either overtly or covertly attempted to minimize future competition against incumbent legislators.[300] This subject has been touched upon by the courts, resulting in confusion over whether the equal protection clause forbids or permits the goal of protecting incumbents. If this goal is permitted, the question remains whether it is rational to limit to an arbitrary percentage the interdistrict population variations permitted to further such a goal.

In one of the first cases after *Reynolds* to consider this problem, the Nebraska District Court in *League of Nebraska Municipalities v. Marsh*[301] heard a challenge to a districting plan that had been created

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this subject are probably true. It is hard to envision a state that has no unique geographic, demographic, economic, historic, or topographic factors which could be used to deviate from equality of population, even where equality is otherwise feasible.

[295]420 U.S. 1 (1974).

[296]*Id.* at 24.

[297]*Id.* at 25.

[298]*Karcher*, 462 U.S. at 740.

[299]*Brown*, 462 U.S. at 841.

[300]*See, e.g.*, Burns v. Richardson, 384 U.S. 73, 89 n.16 (1965) (protection of incumbents does not itself establish invidiousness).

[301]242 F. Supp. 357 (D. Neb. 1965).

in part to avoid contests between incumbents.[302] The district court found that a plan with population variations that could be explained at least partly as an attempt to minimize incumbent contests did not represent a good faith effort to achieve equality of population among districts.[303] The court invalidated the plan,[304] stating that under *Reynolds*, the goal of reapportionment was "just representation of the people, not the protection of incumbents in the legislative body."[305] This reasoning seemed to follow the idea in *Reynolds* that attempts at equality must be made in good faith. Because good faith required a sincere effort on the part of the legislators to clear everything from their minds except population when devising an apportionment plan, protection of incumbents was not permissible.

The reasoning in *Marsh* was used elsewhere. In *Klahr v. Williams*,[306] a challenge to the redistricting of Arizona uncovered the fact that the computer used to devise the plan had been programmed to minimize contests between incumbent legislators.[307] Because of the consequent interdistrict variations in population, the court found the plan defective.[308] The court agreed with the district court of Nebraska in concluding that "the incumbency factor has no place in any reapportionment or redistricting."[309]

In *Burns v. Richardson*,[310] the Supreme Court had merely indicated its position in a footnote that plans designed to avoid incumbency battles were not necessarily invidious.[311] Indeed, under equal population districts, a decision to avoid incumbent battles need not necessarily dilute the strength of any individual voter. When the courts in *Marsh* and *Klahr* examined the challenged plans, however, the evidence was unmistakable that the goal of reducing incumbency fights had contributed to the variation in population among the districts. By realizing that the government was not designed to make it convenient to run for office, the courts rationally concluded that incumbency was not a legitimate basis for those population variations.

After the Supreme Court said that incumbency protection was not necessarily invidious, it seemed that while the Court was not prepared to invalidate automatically a district drawn to prevent incumbency fights, it would do so when population variations could be reduced by removing that criterion from consideration. In *Karcher*, however, decided the same

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[302] *Id.* at 359-60.
[303] *Id.* at 361.
[304] *Id.*
[305] *Id.* at 360.
[306] 313 F. Supp. 148 (D. Ariz. 1970).
[307] *Id.* at 151-52.
[308] *Id.* at 151.
[309] *Id.* at 152.
[310] 384 U.S. 73 (1966).
[311] *Id.* at 89 n.16.

day as *Brown*, Justice Brennan, writing for the majority, listed a host of state policies, including avoiding incumbent battles, that might justify population variations.[312] Because even the majority in *Karcher* seemed to accept avoidance of incumbency contests as a legitimate reason for population variation in Congressional districting, the looser standards already acknowledged for state redistricting could now be permitted as well. Thus, the clear and easy mandate of *Reynolds* is clouded further.

I. Ambiguous, Cautious Language

One source of problems for those given responsibility for implementing *Reynolds* is the potentially contradictory and weak language that crept into the opinion. Generally, the opinion required equality of voting power through population-based apportionment. Occasionally, however, the Court's language was equivocal. For example, in the conclusion of the passage concerning bicameralism, the *Reynolds* Court made the statement that "these and other factors could be, and are presently in many States, utilized to engender differing complexions and collective attitudes in the two bodies of a state legislature, although both are apportioned *substantially* on a population basis."[313] It is unclear why the Court included the word "substantially." Earlier, the Court had made its announcement that "[f]ull and effective participation by all citizens in state government requires, therefore, that *each* citizen have *an equally effective voice* in the election of members of his state legislature."[314] "Equal" is an absolute; either a person's vote counts the same as other votes or it does not. Thus, there is no room for modifying "equal" with "substantially."

Elsewhere in *Reynolds*, the Court had written that "[p]opulation is, of necessity, the starting point for consideration and the controlling criterion for judgment in legislative apportionment controversies."[315] Immediately below the passage indicating that bicameralism was still viable for houses apportioned "substantially on a population basis,"[316] the Court wrote:

> By holding that as a federal constitutional requisite both houses of a state legislature must be apportioned on a population basis, we mean that the Equal Protection Clause requires that a State make an honest and good faith effort to construct districts, in both houses of its legislature, as nearly of equal population as is practicable.[317]

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[312] *Karcher*, 462 U.S. at 740.
[313] 377 U.S. at 577 (emphasis added).
[314] *Id.* at 565 (emphasis added).
[315] *Id.* at 567.
[316] *Id.* at 577.
[317] *Id.*

The opinion thereby creates confusion as to whether a state legislature must make a good faith effort to achieve interdistrict population equality or merely a good faith effort to achieve substantial interdistrict population equality. In theoretical terms, this distinction is potentially great. A commitment to equality of voting power eliminates all non-neutral, non-population districting restrictions. A commitment to substantial equality requires elimination of only the least favored non-neutral districting requirements.

As long as the Warren Court was reviewing state apportionment plans, the commands of the equal protection clause as interpreted in *Reynolds* actually served the goal of equality of voting power. When *Kirkpatrick*[318] and *Swann*[319] established that there was no *de minimus* level for reviewing congressional apportionment cases, it seemed a logical conclusion that the same sternness toward interdistrict inequalities would apply under the equal protection clause.[320]

In 1972, however, the new Burger Court majority in *Mahan* seized upon the *Reynolds* dicta examined above to find that a different standard of review existed for state legislative apportionment. The dichotomy accepted in *Mahan* seemed a natural predicate, however, to a Court more concerned with protecting the autonomy of state legislatures than with individual voting rights.

By the time *Gaffney*[321] was decided, the primary goal identified by the language "equally effective vote" for each citizen[322] had been altered. No longer was the Court even verbally committed to equality of representation at the state level. Instead, it would suffice under the equal protection clause for a state to provide "fair and effective representation."[323] This change in wording permitted substantial deviations from equality within the districts. As Justice Brennan reaffirmed in the majority opinion of *Karcher*, article I, section 2 continues to "establish a high standard of justice and common sense for the apportionment of congressional districts: equal representation for equal numbers of people."[324]

In contrast, the language of *Brown* reflects a different understanding of *Reynolds*. Justice Powell conceded that the policy advanced by the state would not guarantee protection for any magnitude of population deviation: "Even a neutral and consistently applied criterion such as use of counties as representative districts can frustrate *Reynolds'* mandate of fair and effective representation if the population disparities are excessively high."[325] This language appears to be based on *Reynolds* but

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[318]394 U.S. 526.

[319]385 U.S. 440.

[320]Mahan v. Howell, 410 U.S. 315, 334, 340 (Brennan, J., dissenting).

[321]412 U.S. 735.

[322]377 U.S. at 565. *See also id.* at 579.

[323]412 U.S. at 749.

[324]*Karcher*, 462 U.S. at 730 (quoting Wesberry v. Sanders, 376 U.S. 1, 18 (1964)).

[325]*Brown*, 462 U.S. at 845.

actually sidesteps *Reynolds*' primary concern with equality.[326] The *Reynolds* Court had discussed fair and effective participation only through the mechanism of equality of voting power.[327]

The transition from strict equality to "fair and effective representation" apparently took place first in 1972 in *Gaffney v. Cummings*[328] when the court considered a Connecticut apportionment scheme. While *Reynolds* had been cast principally in terms of equal representation and equal voting power, as reflective of the constitutional clause under which the challenges were mounted, the Court in *Gaffney* made the transition in reapportionment cases to a discussion of whether the apportionment scheme provided for "fair and effective"[329] representation. Because "fair" and "equal" are not synonymous,[330] this change of language is a sign of the Court's changing attitude toward the requirements of the equal protection clause. Based on this changed focus, any guidelines that had developed were then weakened or destroyed by *Brown*. The Court in the early 1970's thus began to review the reapportionment cases with focus on the due process clause and not on the equal protection clause — on notions of fairness rather than notions of equality.

The effect of dropping the "equality" standard of *Reynolds* has been to make the Court's scrutiny a balancing test rather than a search for equality and justification for deviations from equality. Unfortunately, the transition from the Court's commitment to equality to its search for fairness has not been accompanied by standards to measure that fairness. Thus, the courts and legislatures are left, after *Brown*, to their own diverse conclusions as to what "fair and effective" representation may be. This result is another step towards confusion in apportionment, a confusion that could end in the submersion of equality.

IV. Implications

Between 1971 and 1983, the Supreme Court tended to resolve questions between the state and an individual in favor of the state. Several of the current Justices are known for their states' rights position,[331] and the direction taken in the apportionment cases suggests that greater deference will be given to state legislative bodies in dividing their territory for state legislative districts. The primary goal of equality has become burdened with more and more tangled factors that have justified deviations from pure mathematical equality.

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[326]*See supra* note 322.

[327]377 U.S. at 565.

[328]412 U.S. 735.

[329]*Id.* at 749 ("minor deviations which do not deprive one of fair and effective representation in his state legislature are not invalidated by the Equal Protection Clause").

[330]Fair means having the qualities of impartiality and honesty. Black's Law Dictionary 535 (5th ed. 1979). Equal means "on the same . . . level with." *Id.* at 481.

[331]Note, for example, National League of Cities v. Usery, 426 U.S. 833 (1976), and its progeny.

Just as more and more responsibility is being shifted to the states, it appears that the Court is preparing to slacken its commitment to individual equality of voting power. This may mean that the future will permit more state decisions made by fewer representative groups than *Reynolds* envisioned. This result is particularly disconcerting because, while *Reynolds* and even *Brown* still pose some limits to interdistrict population deviation, the disparate approaches in those cases will result in gross inconsistencies. Apportionment in many states may satisfy neither the goal of equality demanded by the federal Constitution nor the goals of individual state constitutions which regulate apportionment on a non-population basis. Therefore, both the state and federal constitutions are frustrated to varying degrees, while no rational basis exists for such a result in either constitutional documents, needs of state government, or theories of political structure. The by-product of *Brown* is the unleashing of claims for inequality that could result in irrational patterns of apportionment.

Would it not be better simply to require, as the Supreme Court does now in congressional districting, that the goal of population equality be reached as closely as practicable, regardless of county boundaries? This policy would still permit a state to honor such factors as political subdivision boundaries where convenient, but would put states under no obligation to strain to salvage those boundaries at the expense of equality. This approach would facilitate equality of voting power, support legislative freedom from federal intrusion, and minimize litigation and political infighting over the apportionment process.

The theory of *Karcher*, if applied to state legislative apportionment, would solve most of the perplexing and insoluble conflicts in state legislative apportionment law. While superficially very intrusive, a flat rule that absolute equality is the primary goal of apportionment has the simplicity that will enable a legislature to monitor its own compliance with the equal protection clause. Instead of establishing a system which requires court approval and involves court delay and antagonism every time reapportionment is carried out, a flat and simple rule would minimize the courts' future role in evaluating apportionment schemes.

While even *Reynolds* considered that there are some legitimate bases for variation among districts, the evolution of congressional apportionment cases indicates that, where a real effort is made, those variations can be fashioned to produce only minute inequalities. Permitting greater inequalities than are inherent in the measurement and quantification of population seems unnecessary given the current development of computer technology for constructing districts. Furthermore, lest such development hastens a trend to equipopulous gerrymandering, the Court should indicate its willingness to use the due process clause to develop, along the line of Justice Stevens' concurrence in *Karcher*,[332] rules to prohibit any

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[332]*See supra* text accompanying notes 59-62. *See also* Davis v. Bandemer, No. 84-

blatant attempt to dilute the effectiveness of any particular recognizable group. Just as computers can be programmed to give extraordianry gerrymanders, they can be programmed to construct completely neutral-criteria equipopulous districts. The role of the Court should be to ensure that that is done whenever feasible.

The framers of the Constitution could have selected other modes of representation other than population — and they did so under the demands for compromise.[333] When the agony of the Civil War gave birth to the equal protection clause in the fourteenth amendment and a renewed commitment to equality, however, a profound commitment to a particular kind of democracy was made. Until the Court reviews its position on state apportionment and reduces the unhealthy tension between outdated provisions of state constitutions and the commands of the equal protection clause, it can assuredly be said of America's state elections that "some voters are more equal than others."[334] Such a situation can only breed contempt for the system that fosters such inequality. It would behoove the Court to re-think its position on state level reapportionment and develop methods, where necessary, to ensure that the primary goal in apportionment in each state remains equality and that the chance for hostile division over the goals of apportionment be avoided. If this is not done, the judicial distemper which now surfaces when apportionment cases arise in the states can only increase in the years to come.

The vision of America as a country committed to equality in its Constitution is tarnished by a judicial system that permits a compromise of equality to the extent seen in *Brown*. The realities of reapportionment litigation after *Brown* suggest that tension between state and federal constitutions will allow gross inequalities of voting power based on one or many of the competing interests legitimized by *Brown*. Furthermore, that tension, along with confusing strands of legal theory and rules built up or around dicta in *Reynolds*, inhibits the orderly growth of a rational and consistent approach to apportionment under the federal Constitution. The Court's re-examination of *Brown* and an application of the strict equality standards of *Kaurcher* could eliminate the unhealthy tension and confusion experienced by state legislatures, courts, and the federal government when they are faced with state reapportionment questions.

1244 (U.S. oral argument heard Oct. 7, 1985) (decision pending).

[333]"Representatives . . . shall be apportioned among the several States . . . according to their respective Number of free persons, . . . and three fifths of all other Persons. U.S. CONST. art. I, § 2, col. 3. This was the famous compromise to mollify the slave states.

[334]*See supra* note 315.

Notes

The Effect of NCAA v. *Board of Regents* on the Power of the NCAA to Impose Television Sanctions

I. Introduction

In *Goldfarb v. Virginia State Bar*,[1] the Supreme Court made it clear that the provisions of the Sherman Anti-Trust Act (Sherman Act)[2] are applicable to anticompetitive activities outside the normal business context.[3] The *Goldfarb* decision brought professional associations, as well as non-profit organizations, under the antitrust spotlight. Among the newcomers to antitrust scrutiny in the wake of *Goldfarb* was the National Collegiate Athletic Association (NCAA), a non-profit organization which regulates collegiate athletics.

After *Goldfarb*, the NCAA successfully weathered the initial antitrust challenges to a number of its regulations.[4] In *National Collegiate Athletic Association v. Board of Regents of the University of Oklahoma*,[5] though, the Supreme Court held that the NCAA's college football television plan, whereby the NCAA collectively sold the television rights to member schools' football games while limiting the number of television appearances any member school could make, was an unlawful restraint of trade under section 1 of the Sherman Act.[6]

The Court's holding in *Board of Regents* has raised questions regarding the continued ability of the NCAA to regulate collegiate athletics. Specifically, the holding brings into question the continued ability of the NCAA to sanction member schools that violate the association's rules by

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[1]421 U.S. 773 (1975).

[2]15 U.S.C. §§ 1-7 (1982). This Note will primarily be concerned with § 1 of the Act, which provides in pertinent part: "Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal. . . ." 15 U.S.C. § 1 (1982).

[3]The Court in *Goldfarb* held that a fee schedule published by a county bar association was not immune to an attack under the Sherman Act. *Id.*

[4]Hennessey v. NCAA, 564 F.2d 1136 (5th Cir. 1977) (upholding NCAA rule limiting number of assistant football coaches member institutions could employ); Justice v. NCAA, 577 F. Supp. 356 (D. Ariz. 1983) (upholding NCAA sanctions prohibiting University of Arizona football team from appearing on television and from participating in post-season bowl games); Jones v. NCAA, 392 F. Supp. 295 (D. Mass. 1975) (upholding NCAA eligibility guidelines); College Athletic Placement Service, Inc. v. NCAA, 1975-1 Trade Cas. (CCH) ¶ 60,117 (D. N.J. 1974) (upholding NCAA rule forbidding use of athletic placement services).

[5]104 S. Ct. 2948 (1984).

[6]*See supra* note 2.

prohibiting them from appearing on television. The Court in *Board of Regents*, while holding that the television plan was violative of the Sherman Act, did not address the question whether the NCAA's television sanctions were also an illegal restraint of trade under section 1 of the Sherman Act.

This Note will examine the Supreme Court's decision in *NCAA v. Board of Regents* and analyze the ramifications of that decision with regard to the NCAA's power to levy television sanctions. The Note will subject the television sanctions to an antitrust analysis and suggest that, in light of the *Board of Regents* decision, the NCAA's television sanctions are a violation of section 1 of the Sherman Act.

II. Background of the *Board of Regents* Decision

A. The NCAA and the College Football Television Plan

In its constitution, the NCAA states that its basic purpose is "to maintain intercollegiate athletics as an integral part of the educational program and the athlete as an integral part of the student body and, by so doing, retain a clear line of demarcation between college athletics and professional sports."[7] The National Collegiate Athletic Association was founded in 1905 in response to a generally chaotic situation in intercollegiate athletics.[8] Since its inception, the NCAA has grown to include 991 member institutions[9] and has been judicially noticed as the "dominant" intercollegiate sports organization.[10] The NCAA sponsors seventy-four national championships in twenty sports for members in three separate divisions[11] and promulgates playing rules, standards for academic eligibility, athletic recruiting regulations, and rules governing the size of athletic teams and coaching staffs.[12]

The NCAA instituted the first of its college football television plans in 1951.[13] The original plan came into being because of a fear of the

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[7]Constitution and Interpretations of the NCAA, art. II, § 2(a), *reprinted in* [1984-85] Manual of the National Collegiate Athletic Association 7, 8.

[8]Note, *Tackling Intercollegiate Athletics: An Antitrust Analysis*, 87 Yale L.J. 655, 656 (1978).

[9]NCAA News, Sept. 10, 1984, at 1, col. 1.

[10]College Athletic Placement Service, Inc. v. NCAA, 1975-1 Trade Cas. (CCH) ¶ 60,117 (D. N.J. 1974).

[11]Bylaws and Interpretations of the National Collegiate Athletic Association, art. V, § 6, *reprinted in* [1984-85] Manual of the National Collegiate Athletic Association, 98-101.

[12]104 S. Ct. at 2954.

[13]Hochberg, Horowitz, *Broadcasting and CATV: The Beauty and the Bane of Major College Football*, 38 Law & Contemp. Probs. 112, 114 (1973). College football is the only sport in which the NCAA has attempted to regulate its member schools' television appearances. Television arrangements for college basketball, which is the only other NCAA sport to attract national television coverage for regular season games, are made by the schools themselves

effect television would have on live attendance at games. The plan allowed only one game a week to be telecast in each area with a total television blackout on three of the ten Saturdays during the season.[14]

The NCAA's football television plan evolved into a multi-million dollar bonanza for the NCAA and its member institutions. The contract ruled invalid by the court of appeals in *Board of Regents* would have garnered the NCAA a total of $263.5 million from Columbia Broadcasting System (CBS) and the American Broadcasting Companies (ABC) over four years, plus $17.696 million from Turner Broadcasting System, Incorporated (TBS) over two years.[15]

The plan struck down by the Supreme Court contained the same essential features as the NCAA television plans which had preceded it.[16] The networks would pay to each participating school a recommended fee set by a representative of the NCAA for the different types of telecasts. Higher fees would be set for games to be telecast nationally and lower fees set for games to be telecast regionally or for games involving smaller schools (such as schools from NCAA Division II or Division III as opposed to Division I schools).[17] The total payments for all games would have apparently equaled the $263.5 million "minimum aggregate compensation" specified in the contracts.[18] Except for the difference in fees between regional and national telecasts or Division I, II and III games, the amount paid to any team participating in a televised game would not vary regardless of the size of the viewing audience, number of markets in which the game was telecast, or the potential interest in the game.[19] For example, a regional telecast airing in a limited number of markets of a game between two traditionally weak football schools would command the same fee as a regional telecast airing in a large number of markets between two traditional college football powerhouses.[20]

The NCAA's television plan also required the networks to schedule appearances for at least eighty-two different member institutions during

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or by the athletic conferences of which they are members. Bd. of Regents of Univ. of Okla. v. NCAA, 546 F. Supp. 1276, 1284-5 (W.D. Okla. 1982).

[14]104 S. Ct. at 2955.

[15]Bd. of Regents of Univ. of Okla. v. NCAA, 546 F. Supp. 1276, 1291-92 (W.D. Okla. 1982).

[16]104 S. Ct. at 2955.

[17]*Id.* at 2956.

[18]*Id.*

[19]*Id.*

[20]The district court described an occasion in which a game between little-known Appalachian State and Citadel was aired on four of ABC's affiliated stations while a game on the same day between the University of Southern California and the University of Oklahoma, both of which were rated among the top five teams nationally, was aired on over two hundred ABC affiliates. All four teams, however, received exactly the same fees for their television appearances. 546 F. Supp. at 1291.

each two-year period of the four-year contracts.[21] Each member institution was limited to a maximum of six televised games in a two-year period.[22] No NCAA member could make any independent sale of television rights except in accordance with the NCAA plan.[23]

B. Dissatisfaction with the NCAA Television Plan

Disenchantment with the NCAA plan and other aspects of the NCAA's regulation of college football prompted several of the NCAA members to form the College Football Association (CFA).[24] The CFA restricted its membership to football-playing schools which met certain standards of size and dominance. CFA membership eventually came to include every major football-playing school with the exception of the members of the Big 10 and Pacific 10 conferences.[25]

Beginning in 1979, the CFA members actively began to seek a greater voice in the formation of television football policy.[26] In 1981, the CFA developed an independent television plan and obtained a contract offer from the National Broadcasting Company (NBC) which would have increased revenues and the number of appearances for CFA members.[27] The CFA signed the contract and the NCAA took prompt action, threatening sanctions against any CFA member that participated in the CFA-NBC contract.[28] The NCAA's threats apparently worked because the CFA-NBC contract was never consummated.[29] Nonetheless, the University of Oklahoma and the University of Georgia, both CFA members, filed suit in United States District Court for the Western District of Oklahoma, challenging the NCAA television plan as violative of the Sherman Anti-Trust Act.[30]

III. *NCAA v. Board of Regents of the University of Oklahoma*

A. The District Court Decision

The district court held that the NCAA's football television controls

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[21] 546 F. Supp. at 1293.

[22] *Id.*

[23] "Any commitment by a member institution with respect to telecasting or cablecasting or otherwise televising its football games in a future season or seasons shall be subject to the terms of the NCAA football television principles and supporting plan provisions applicable to such season(s) for that institution's football division." Bylaws and Interpretations of the National Collegiate Athletic Association, art. VIII, § 2(d), *reprinted in* [1984-85] MANUAL OF THE NATIONAL COLLEGIATE ATHLETIC ASSOCIATION 115-16.

[24] 546 F. Supp. at 1285.

[25] *Id.*

[26] *Id.*

[27] *Id.* at 1286.

[28] *Id.* For a list of possible sanctions which could be imposed by the NCAA, *see infra* note 82.

[29] *Id.* at 1286-87.

[30] *Id.* at 1301.

were violations of sections 1 and 2 of the Sherman Act.[31] The court concluded that the NCAA's controls over college football made the NCAA a "classic cartel."

> This cartel has an almost absolute control over the supply of college football. . . . Like all other cartels, NCAA members have sought and achieved a price for their products which is, in most instances, artificially high. The NCAA cartel imposes production limits on its members and maintains mechanisms for punishing cartel members who seek to stray from these production quotas. The cartel has established a uniform price for the products of each of the member producers, with no regard for the differing quality of these products or the consumer demand for these various products.[32]

The district court went on to find that the NCAA's college football plan constituted illegal *per se* price fixing and an illegal *per se* group boycott in violation of section 1 of the Sherman Act.[33]

Despite its finding of *per se* illegalities, the court went on to discuss the NCAA's restraints under the rule of reason.[34] Under a rule of reason analysis, the goals and purposes served by a challenged restraint (the restraint's procompetitive justifications) are balanced against the anticompetitive effects of the restraint in order to determine its legality.[35]

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[31] *Id.*

[32] *Id.* at 1300-01.

[33] *Id.* at 1311. Certain agreements are so clearly anticompetitive that they are deemed to be illegal *per se*. Such arrangements will be declared illegal without elaborate inquiry into the harm they have caused or the excuse for their use. *See generally* United States v. Topco Associates, Inc., 405 U.S. 596 (1972); Northern Pac. Ry. v. United States, 356 U.S. 1 (1958).

[34] 546 F. Supp. at 1314.

[35] The classic statement of the rule of reason appeared in an opinion written by Justice Brandeis in *Bd. of Trade of the City of Chicago v. United States*:

> [T]he legality of an agreement cannot be determined by so simple a test as whether it restrains competition. Every agreement concerning trade, every regulation of trade, restrains. To bind, to restrain, is of their very essence. The true test of legality is whether the restraint imposed is such as merely regulates and perhaps thereby promotes competition, or whether it is such as may suppress or even destroy competition. To determine that question the court must ordinarily consider the facts peculiar to the business. . . its condition before and after the restraint was imposed; the nature of the restraint and its effect, actual and probable. The history of the restraint, the evil believed to exist, the reason for adopting the particular remedy, the purpose or end sought to be obtained, are all relevant facts. This is not because a good intention will save an otherwise objectionable regulation, or the reverse; but because knowledge of intent may help the court to interpret facts and to predict consequences.

246 U.S. 231, 238 (1918).

For a more detailed description of the rule of reason and *per se* doctrines, *see* L. SULLIVAN, HANDBOOK OF THE LAW OF ANTITRUST 165-86 (1977).

The district court concluded that the restraints in the NCAA's college football television plan were unreasonable.[36] "The controls are unreasonable by their very nature and character, and the history and circumstances surrounding the controls lead readily to the inference that they were intended to restrain and enhance prices."[37]

The court then analyzed the plaintiffs' charge of monopolization under section 2 of the Sherman Act and concluded that the NCAA had monopolized the market of college football television.[38] The court granted relief by declaring the NCAA's television contracts with ABC, CBS, and TBS illegal and by enjoining the NCAA from taking any part in the formation of agreements regarding the televising of member institutions' football games.[39]

B. The Appeals Court Decision

The court of appeals affirmed the district court's finding that the NCAA's television plan constituted *per se* illegal price fixing.[40] Nonetheless, the court noted the prospect of review by the Supreme Court and followed the lead of the district court by applying a rule of reason analysis to the NCAA's television plan despite the finding of *per se* illegality.[41]

In its rule of reason analysis, the appeals court first assessed the NCAA's market power in the relevant market of televised collegiate football.[42] After determining that the NCAA did possess market power and that its television plan produced anticompetitive results, the court turned to the NCAA's justification for the restraints.[43] The NCAA asserted that the television plan promoted athletically balanced competition, but the court found that the same result could be accomplished by means not violative of the antitrust laws.[44] The NCAA's second justification was that the restraints were necessary to penetrate the network programming market.[45] The court rejected this argument after noting that many of the schools whose games were televised to penetrate the market, i.e., the football powers of the CFA, were not pleased with the NCAA's restraints and that the NCAA had used its control of intercollegiate athletics to obtain

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[36]546 F. Supp. at 1315.

[37]*Id.*

[38]*Id.* at 1323.

[39]*Id.* at 1326-27.

[40]Bd. of Regents of University of Okla. v. NCAA, 707 F.2d 1147, 1156 (10th Cir. 1983).

[41]*Id.* at 1157.

[42]*Id.* at 1158.

[43]*Id.* at 1159.

[44]*Id.* at 1159-60.

[45]The court found that a properly drawn system of pass-over payments would be one way to ensure adequate athletic funding for schools not earning substantial television revenues. *Id.* at 1159.

control of broadcast rights to intercollegiate football.[46] "In these circumstances we are not particularly disposed to consider the plan's impact on competition within the larger network programming market to be redeemingly procompetitive."[47]

The court finally concluded that the district court had erred in holding the plan to be a group boycott illegal *per se* under section 1 of the Sherman Act and remanded the case to the district court in order for the NCAA to present its concerns regarding the breadth of the injunction issued by the court.[48] The court noted that part of the district court's injunction might be read so as to prevent the NCAA from imposing television sanctions on schools that violate regulations unrelated to the television plan, and that such an effect was not warranted by the violations found.[49]

Judge Barrett filed a dissent in which he labeled the majority's finding that the NCAA's television plan was illegal *per se* price-fixing.[50] Judge Barrett said that the primary purpose of the television plan was not anticompetitive. "Rather, it is designed to further the purposes and objectives of the NCAA, which are to maintain intercollegiate football as an amateur sport and an adjunct of the academic endeavors of the institution."[51]

C. The Supreme Court Decision

The Supreme Court first found that the NCAA's television plan constituted forms of horizontal price-fixing[52] and output limitations.[53] The Court then went on to say that while such restraints were ordinarily condemned as illegal *per se*, the restraints should be analyzed under a rule of reason approach.

> This decision is not based on a lack of judicial experience with this type of arrangement, on the fact that the NCAA is organized

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[46] *Id.* at 1160.

[47] *Id.*

[48] *Id.* at 1162.

[49] *Id.* Paragraph four of the district court's injunction reads:

> National Collegiate Athletic Association, its officers, agents or employees shall be and hereby are enjoined from prohibiting member institutions from selling or assigning their rights to telecast the college football games in which they participate, and from requiring as a condition of membership that those institutions grant to the National Collegiate Athletic Association the power to control those institutions' rights to telecast college football games.

Id.

[50] *Id.*

[51] *Id.* at 1163.

[52] Horizontal price-fixing occurs when competing sellers fix the prices of their products. *See* Columbia Broadcasting Sys. v. Am. Soc. of Composers, Authors and Publishers, 620 F.2d 930 (2d Cir. 1980).

[53] 104 S. Ct. at 2959-60.

> as a nonprofit entity, or on our respect for the NCAA's historic role in the preservation and encouragement of intercollegiate amateur athletics. Rather, what is critical is that this case involves an industry in which horizontal restraints are essential if the product is to be available at all.[54]

The Court found that the product marketed by the NCAA and its member institutions was competition, or, more specifically, contests between competing universities. Rules and regulations were necessary restraints which allowed the production of marketable competition. "Thus, the NCAA plays a vital role in enabling college football to preserve its character, and as a result enables a product to be marketed which might otherwise be unavailable."[55]

The Court agreed with the district court's finding that the college football telecasts constituted a separate market in that they generated an audience uniquely attractive to advertisers which could not be generated by other programming alternatives.[56] The Court also agreed that the NCAA did possess market power, although it pointed out that no showing of market power is necessary to demonstrate the anticompetitive nature of agreements to restrict price or output.[57]

The Court then considered the NCAA's justifications for the restraints in the television plan. The NCAA relied on *Broadcast Music, Inc. v. Columbia Broadcasting System, Inc.*[58] to argue that its television plan constituted a joint venture which assisted in the marketing of television rights and was therefore procompetitive.[59] The Court rejected this argument, relying on the district court's finding that NCAA football could be marketed just as effectively without the television plan.[60] The Court also

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[54]*Id.* at 2960-61.

[55]*Id.* at 2961.

[56]*Id.* at 2966.

[57]*Id.* at 2965-66. *See* Nat'l Soc'y of Professional Eng'rs v. United States, 435 U.S. 679, 692 (1978).

[58]441 U.S. 1 (1979). The case involved a suit brought by CBS against licensing agencies for composers, writers, and publishers and their members and affiliates. CBS alleged that the agencies' issuance of blanket licenses to the broadcast rights of a large number of copyrighted musical compositions at fees negotiated by the agencies was illegal price-fixing under the antitrust laws. The Court held that while the license fee was set by the agencies rather than by competition in the market, the issuance of blanket licenses did not constitute price-fixing that was *per se* unlawful under the antitrust laws. The Court found procompetitive efficiencies created by the blanket licenses in integration of sales and the monitoring and enforcement against unauthorized copyright use, which would present difficult and expensive problems if left to the individual users and copyright owners. The Court also found that the blanket license had provided an acceptable mechanism for at least a large part of the market for performing rights to copyrighted musical compositions.

[59]104 S. Ct. at 2967.

[60]*Id.*

reasoned that if the NCAA's television plan produced procompetitive efficiencies, the plan would increase output and reduce the price of televised games.[61] Relying on the district court's finding that the plan had the opposite effect, the Court dismissed the NCAA's argument.[62]

The Court next dealt with the NCAA's argument that the television plan protected live attendance at college football games. The Court first noted that under the NCAA's plan, games were shown on television at all hours that college football was played. Thus, "the plan simply does not protect live attendance by ensuring that games will not be shown on television at the same time as live events."[63] The Court also rejected the argument on the grounds that it was based on a fear that the product would not be attractive enough to draw live attendance when faced with competition from televised games. "At bottom the NCAA's position is that ticket sales for most college games are unable to compete in a free market."[64]

The final procompetitive justification proffered by the NCAA in support of its television plan was that it helped maintain competitive balance among amateur athletic teams.[65] The Court acknowledged that maintaining competitive balance was a legitimate justification for many of the restraints imposed by the NCAA on its member institutions. "It is reasonable to assume that most of the regulatory controls of the NCAA are justifiable means of fostering competition among amateur athletic teams and therefore procompetitive because they enhance public interest in intercollegiate athletics."[66] However, the Court concluded that the NCAA's television plan did not serve the interest of balanced competition.

> The television plan is not even arguably tailored to serve such an interest. It does not regulate the amount of money that any college may spend on its football program, nor the way in which the colleges may use the revenues that are generated by their football programs, whether derived from the sale of television rights, the sale of tickets, or the sale of concessions or program advertising.[67]

The Court reinforced its conclusion by pointing out that maintenance of competitive balance is a procompetitive justification under the rule of reason based on the theory that equal competition maximizes consumer

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[61] *Id.*
[62] *Id.* at 2967-68.
[63] *Id.* at 2968-69.
[64] *Id.* at 2969.
[65] *Id.*
[66] *Id.*
[67] *Id.* at 2970.

demand. "The finding that consumption will materially increase if the controls are removed is a compelling demonstration that they do not in fact serve any such legitimate purpose."[68]

Justice White[69] was joined by Justice Rehnquist in the dissent. Justice White felt the Court had erred in treating intercollegiate athletics as a purely commercial venture, and that the justifications forwarded by the NCAA for its television plan were valid.[70] Along with accepting the NCAA's procompetitive justifications, Justice White agreed with the NCAA's position on the general ground that "the television plan reflects the NCAA's fundamental policy of preserving amateurism and integrating athletics and education."[71]

Justice White took issue with most of the findings of the majority as well as those of the lower courts. Justice White particularly objected to the lower courts' and majority's definition of the relevant market.[72] In Justice White's view, the proper market in which to analyze the NCAA's restraints was the entertainment market rather than the narrow market of college football television. Because college football was competing within the broad spectrum of the entertainment market, the television plan was a justifiable means of enhancing college football's ability to compete within that market.[73]

Justice White concluded by arguing that the majority and the lower courts failed to take into account "the essentially noneconomic nature of the NCAA's program of self-regulation."[74] Specifically, Justice White argued that "the plan fosters the goal of amateurism by spreading revenues among various schools and reducing the financial incentives toward professionalism."[75] According to Justice White, the television plan helped to encourage students to choose their schools on the basis of educational quality, ensured the economic viability of other athletic programs at schools with weaker football programs, and promoted competitive balance. "These important contributions . . . are sufficient to offset any minimal anticompetitive effects of the television plan."[76]

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[68] *Id.*

[69] It is interesting to note that Justice White was an All-American selection in football when playing for the University of Colorado in 1937. CLAASSEEN, ENCYCLOPEDIA OF FOOTBALL 10-5 (1963).

[70] 104 S. Ct. at 2971-73.

[71] *Id.* at 2973.

[72] *Id.* at 2976-77.

[73] *Id.* at 2977.

[74] *Id.*

[75] *Id.* at 2978.

[76] *Id.* at 2979.

D. Aftermath of the Board of Regents *Decision*

The decision in *Board of Regents* had immediate and sometimes confusing effects. The NCAA scrambled to put together an alternative television plan, but the plan was voted down by the NCAA membership on July 11, 1984, leaving the CFA, Big 10, and Pacific 10 conferences free to negotiate their own television contracts with the networks.[77] The CFA eventually entered into an agreement with ABC and the Entertainment and Sports Programming Network (ESPN) while the Big 10 and Pacific 10 signed an agreement with CBS.[78]

Those contracts quickly generated more litigation. The CFA's contract with ABC was an exclusive contract which prohibited CFA members from having their games aired on CBS or NBC. When CFA member Nebraska refused to allow CBS to televise its game with Pacific 10 member UCLA, UCLA, the Big 10, Pacific 10, and the University of Southern California (USC) filed an antitrust suit in district court in Los Angeles against ABC, ESPN, the CFA, Nebraska, and the University of Notre Dame.[79] Judge Richard Gadbois entered a preliminary injunction allowing the game between Nebraska and UCLA to be televised.[80]

Meanwhile, the Association of Independent Television Stations, Incorporated (INTV) filed two separate antitrust suits in Oklahoma City and Los Angeles. INTV alleged that the television contract entered into by the major football coalitions stifled competition and prohibited INTV members rightful access to certain contests.[81] While chaos reigned with regard to television rights, serious questions were being raised about the continued ability of the NCAA to levy television sanctions against member institutions that violated NCAA regulations.[82] The University of Southern California, which had been prohibited from appearing on television in 1983 and 1984, threatened to file suit against the NCAA to have the television sanctions lifted in light of the Supreme Court's decision in *Board*

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[77]Indianapolis Star, July 11, 1984, at 45, col. 2.

[78]The NCAA News, Aug. 1, 1984, at 1, col. 1.

[79]The NCAA News, Sept. 17, 1984, at 1, col. 3. (USC, a Pacific 10 member, was scheduled to have its game against CFA member, Notre Dame, televised on CBS.).

[80]*Id.*

[81]*Id.* at 12, col. 3.

[82]Among the disciplinary measures, singly or in combination, which may be adopted and imposed against an institution are:

> (6) Ineligibility for any television programs subject to the Association's control or administration, or any other television programs involving live coverage of the institution's intercollegiate athletics team or teams in the sport or sports in which the violations occurred.

Official Procedure Governing the NCAA Enforcement Program, § 7(b)(6), *reprinted in* [1984-85] MANUAL OF THE NATIONAL COLLEGIATE ATHLETIC ASSOCIATION 204.

of Regents.[83] The NCAA asserted that the Supreme Court's decision did not interfere with the NCAA's sanctioning power and petitioned the district court for a modification of its injunction in order to clarify the situation.[84] Despite the NCAA's assertion, the NCAA Committee on Infractions permitted member institutions that had been penalized with television bans to enter into commitments to have their 1984 games televised, pending the outcome of the modification hearing.[85] If the district court's injunction were to be modified clearly to give the NCAA permission to impose television sanctions, schools under sanction that chose to have their 1984 games televised would have the sanctions reimposed for 1985.[86] If the NCAA were to be put under a decree precluding television sanctions, the Committee on Infractions would determine whether a substitute penalty should be imposed.[87]

The district court handed down its modified injunction on October 31, 1984.[88] Noting that "it was surely not the Court's intention to have its injunction intrude into areas or activities which were not presented in the original litigation," the court partially granted the NCAA's motion to modify.[89] The court added a seventh paragraph to the injunction which read: "Nothing herein contained shall be construed as prohibiting the National Collegiate Athletic Association, its officers, agents and employees, from: "(b) Imposing sanctions restricting televising of a member's football games for violation of non-television rules and regulations."[90]

IV. Effect of the *Board of Regents* Decision on the NCAA's Power to Impose Television Sanctions

In light of the district court's modified injunction, the NCAA will probably attempt to reimpose its television sanctions for the 1985 college football season. The modified injunction, though, is hardly dispositive of the question regarding the legality of the television sanctions. The district court made it clear that it granted the modification not because it considered the television bans to be valid, but because the question of the

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[83]*Scorecard*, Sports Illustrated, 9, (July 23, 1984).

[84]The NCAA News, Aug. 1, 1984, at 1, col. 2. A hearing on the NCAA's motion to modify was scheduled for Oct. 11-12, 1984. The NCAA News, Sept. 17, 1984, at 1 col. 2. The University of Oklahoma and the University of Georgia opposed any modification in the district court's injunction. The plaintiff's attorney said that his clients would ask the trial court to "fence out" the NCAA's organizational structure from further college football television activities. The NCAA News, July 18, 1984, at 1, col. 3.

[85]The NCAA News, Aug. 1, 1984, at 1, col. 2.

[86]*Id.*

[87]*Id.*

[88]Bd. of Regents of Univ. of Okla. v. NCAA, 601 F. Supp. 307 (W.D. Okla. 1984).

[89]*Id.* at 309.

[90]*Id.* at 310.

validity of the sanctions had not been presented in the original litigation.[91]

Thus, if and when the NCAA attempts to reimpose its television sanctions, those sanctions will still be vulnerable to antitrust challenges. While the specific holding of the Supreme Court in *Board of Regents* does not apply to the NCAA's television sanctions, the rationale applied by the Court would be applicable to an antitrust analysis of the sanctions. The changing nature of the NCAA and intercollegiate athletics would also be relevant to any such analysis.

A. The NCAA and the Preservation of Amateurism

The Supreme Court's acknowledgement in *Board of Regents* of NCAA restraints other than the television plan as "restrictions designed to preserve amateurism"[92] mirrors the perception of lower courts which have upheld NCAA regulations and sanctions in the face of antitrust attacks.[93] The implication seems to be that if the NCAA could have somehow proven that its television plan was tailored to preserve "the integrity of the product"[94] (i.e., preserve amateurism), the plan would have been upheld.

This rationale is exemplified by a series of cases involving challenges to NCAA restraints. In *Justice v. NCAA*,[95] a case decided after the court of appeals' decision in *Board of Regents*, four members of the University of Arizona's football team sought a preliminary injunction to prevent enforcement of sanctions imposed by the NCAA which rendered the team ineligible to participate in post-season play or to make television appearances for two seasons. The court upheld the sanctions. The plaintiffs alleged that the NCAA's sanctions constituted *per se* illegal group boycott.[96] The court rejected the claim of *per se* illegality, distinguishing the NCAA's sanctions from the NCAA's television plan at issue in *Board of Regents*. "The regulations at issue here . . . pertain solely to the NCAA's stated goal of preserving amateurism."[97] The court then analyzed the sanctions under the rule of reason and concluded that the sanctions "have been shown to lack an anticompetitive purpose and to be directly

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[91] *Id.* at 309.

[92] 104 S. Ct. at 2970.

[93] *See* Hennessey v. NCAA, 564 F.2d 1136 (5th Cir. 1977); Justice v. NCAA, 577 F. Supp. 356 (D. Ariz. 1983); Jones v. NCAA, 392 F. Supp. 295 (D. Mass. 1975); College Athletic Placement Service, Inc. v. NCAA, 1975-1 Trade Cas. (CCH) ¶ 60,117 (D. N.J. 1974).

[94] 104 S. Ct. at 2961.

[95] 577 F. Supp. 356.

[96] *Id.* at 378. The court initially opined that the plaintiffs had no standing to assert claims of antitrust violations because their threatened injury was too remote to meet the standing requirement of section 16 of the Clayton Act. However, assuming *arguendo* that the plaintiffs had standing, the court evaluated the merits of the antitrust claim. *Id.*

[97] *Id.* at 379.

related to the NCAA objectives of preserving amateurism and promoting fair competition.''[98] Because the court found that the sanctions had no anticompetitive purposes, were reasonably related to the association's central objectives, and were not overbroad, it accordingly held that there was no unreasonable restraint under section 1 of the Sherman Act.[99]

In *Jones v. NCAA*,[100] a college athlete who had received compensation for playing hockey during two seasons while he was not a student sought an injunction preventing the NCAA from declaring him ineligible to play hockey for Northeastern University. Despite a finding that the Sherman Act was inapplicable to the facts of the case, the court subjected the NCAA's eligibility restrictions to an antitrust analysis.[101] The court found that the purpose underlying the NCAA's eligibility guidelines was not anticompetitive. ''The N.C.A.A. eligibility rules were not designed to coerce students into staying away from intercollegiate athletics, but to implement the N.C.A.A. basic principles of amateurism, principles which have been at the heart of the Association since its founding.''[102] The court went on to deny the plaintiff's injunction.[103]

The NCAA's role in the preservation of amateurism was also cited as a procompetitive justification for NCAA-imposed restrictions in *Hennessey v. NCAA*.[104] In *Hennessey*, two assistant football coaches who had been employed by the University of Alabama challenged an NCAA bylaw which limited the number of assistant coaches certain NCAA member institutions could employ.[105] The court applied a rule of reason analysis to examine the restraint and found that ''[t]he fundamental objective in mind was to preserve and foster competition in intercollegiate athletics . . . and to reorient the programs into their traditional role as amateur sports operating as part of the educational process.''[106] The court went on to conclude that the restraint was valid under the Sherman Act.

B. The Legitimacy of Preservation of Amateurism as a Procompetitive Justification Under the Rule of Reason

With the exception of the district court and appeals court in *Board of Regents*, all of the courts which have undertaken an antitrust analysis of restraints imposed by the NCAA have determined that the restraints

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[98] *Id.* at 382.
[99] *Id.* at 383.
[100] 392 F. Supp. 295 (D. Mass. 1975).
[101] *Id.* at 303.
[102] *Id.* at 304.
[103] *Id.*
[104] 564 F.2d 1136 (5th Cir. 1977).
[105] *Id.* at 1141.
[106] *Id.* at 1153.

should be examined under the rule of reason.[107] In the Supreme Court's decision in *Board of Regents* and in the appeals court's decision in *Hennessey*, this determination was made despite the courts' acknowledgement of *per se* violations. In applying the rule of reason to NCAA-imposed restraints, the courts have demonstrated a willingness to accept the NCAA's stated goal of preservation of amateurism as a legitimate procompetitive justification for the restraints.

The courts' acceptance of preservation of amateurism as a procompetitive justification under the rule of reason is questionable, both as a matter of law and as a matter of fact. Preservation of amateurism indeed may be a noble goal, but it is difficult to see how the pursuit of that goal alone is procompetitive in terms of promotion of economic competition.

> The rule of reason is a standard which calls on courts to judge shades and graduations of competitive impact, a difficult enough inquiry. But the rule does not call on a court to judge whether a restraint of this or that precise degree is justified by its complementary tendency toward some transcendent good.[108]

Despite its apparent approval of NCAA restrictions designed to preserve amatuerism,[109] the Supreme Court in *Board of Regents* noted that "it is . . . well settled that good motives will not validate an otherwise anticompetitive practice."[110] In *National Society of Professional Engineers v. United States*,[111] the Supreme Court found that the purpose of any antitrust analysis "is to form a judgment about the competitive significance of the restraint; it is not to decide whether a policy favoring competition is in the public interest, or in the interest of the members of an industry."[112]

The goal of preservation of amateurism clearly seems to fall within the categories of "transcendent good" or "good motives." It is a policy designed to serve the interests of the members of the NCAA and, standing alone, has no economically competitive significance. A similar justification was rejected by the court in *Denver Rockets v. All-Pro Management, Inc.*[113] In that case, the National Basketball Association (NBA) attempted

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[107]*See, e.g.*, College Athletic Placement Service, Inc. v. NCAA, 1975-1 Trade Cas. (CCH) ¶ 60,117 (D. N.J. 1974).

[108]L. Sullivan, Handbook on the Law of Antitrust 187 (1977).

[109]104 S. Ct. at 2969.

[110]*Id.* at 2960. *See* United States v. Griffith, 334 U.S. 100, 105-06 (1948); Associated Press v. United States, 326 U.S. 1, 16 n.15 (1945); Chicago Bd. of Trade v. United States, 246 U.S. 231, 238 (1918); Standard Sanitary Mfg. Co. v. United States, 226 U.S. 20, 49 (1912).

[111]435 U.S. 679 (1978).

[112]*Id.* at 692.

[113]325 F. Supp. 1049 (C.D. Cal. 1971).

to defend against an antitrust challenge to an NBA rule which prohibited a qualified player from negotiating with NBA teams until four years after his high school class graduation. The NBA attempted to justify the regulation by saying that each prospective basketball player should have the opportunity to complete four years of college before beginning his professional career. The court rejected the justification. "However commendable this desire may be, this court is not in a position to say that this consideration should override the objective of fostering economic competition which is embodied in the antitrust laws."[114]

Even if the preservation of amateurism were a legitimate procompetitive legal justification, the fact is that the preservation of amateurism is no longer the primary purpose of the NCAA, especially in major college football. Courts have accepted the NCAA's claim of preservation of amateurism without applying the same scrutiny to the claim as that applied by the Supreme Court to the NCAA's proffered procompetitive justifications in *Board of Regents*. Such scrutiny would reveal that the true purpose of the NCAA is to ensure the production of a marketable product. As then United States Senator Marlow Cook of Kentucky said in 1973, "The NCAA is primarily designed to protect and defend its member institutions from the professional sports world and to make sure that collegiate sports gets it share of the sports business pie."[115]

The NCAA's bylaws permit major college football teams to award ninety-five "financial aid awards" (scholarships) each year to prospective players with a limit of ninety-five financial aid awards allowed to be in effect in the same year.[116] The awards may cover tuition and fees, room and board, and required course-related books.[117] "Although the colleges euphemistically label this compensation 'financial aid' there can be no question that this aid is, in fact, compensation: student athletes exchange their athletic skills, in a quid pro quo, for a package of goods and services."[118] In effect, the NCAA sets the maximum price which can be paid for intercollegiate athletics and regulates the quantity of athletes that can be "purchased" in a given time period.[119]

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[114]*Id.* at 1066.

[115]Washington Post, Mar. 29, 1973, § C at 1, col. 2.

[116]Bylaws and Interpretations of the National Collegiate Athletic Association, art. VI, § 5(c), *reprinted in* [1984-85] MANUAL OF THE NATIONAL COLLEGIATE ATHLETIC ASSOCIATION 107.

[117]CONSTITUTION AND INTERPRETATION OF THE NCAA, art. III, § 1(9)(1), *reprinted in* [1984-85] MANUAL OF THE NATIONAL COLLEGIATE ATHLETIC ASSOCIATION 12.

[118]Note, *Tackling Intercollegiate Athletics: An Antitrust Analysis, supra* note 8, at 659, n.22.

[119]Koch, *A Troubled Cartel: The NCAA*, 38 LAW & CONTEMP. PROBS., 135, 136-37 (1973).

Even the administrators of the NCAA have come to recognize the fallacy of amateurism in major college football. Walter Byers, the executive director of the NCAA, recently stated that "[t]he structure we have in place as a means of controlling the activities of recruiting and financial aid must go through a dramatic change."[120] Byers suggested the creation of an open division in which athletes would be openly compensated in the form of salaries for their services.[121] Writer Jack McCallum commented, "Byers is essentially right in what he says. Many college sports programs are already semiprofessional, and he's merely suggesting that administrators end the hypocrisy and acknowledge as much."[122] At least one court has acknowledged as much. The Indiana Court of Appeals, in a decision which was later reversed by the state supreme court, awarded a seriously injured Indiana State football player workmen's compensation on the theory that, for purposes of football, he was an employee of the university.[123]

The NCAA's regulations and sanctions purportedly designed to preserve amateurism, then, are in reality designed to place limits on the compensation already received by players legally under NCAA rules. The procompetitive justification for such restraints is not preservation of amateurism but rather promotion of competitive balance. As the Supreme Court found in *Board of Regents*, "What the NCAA and its member institutions market in this case is competition itself—contests between competing institutions."[124] In order to market its product, the NCAA must impose horizontal restraints to define clearly the competition.[125]

By imposing rules limiting the compensation payable to athletes, the NCAA defines its product in such a manner that it is distinguishable from professional football.[126] The restrictions also help to prevent a very few schools with sufficient resources from "buying up" all of the best talent, thus making their games uncompetitive and therefore unattractive to the majority of viewers.

If, then, the NCAA's television sanctions are to be examined under a rule of reason analysis, the courts should not accept the preservation

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[120]*Scorecard*, SPORTS ILLUSTRATED, 11 (Sept. 17, 1984).

[121]*Id.*

[122]*Id.*

[123]Rensing v. Indiana State Board of Trustees, 437 N.E.2d 78 (Ind. Ct. App. 1982), *rev'd*, 444 N.E.2d 1170 (Ind. 1983).

[124]104 S. Ct. at 2961.

[125]*See* Brenner v. World Boxing Council, 675 F.2d 445, 454-55 (2d Cir. 1982); Neeld v. National Hockey League, 594 F.2d 1297, 1299 n.4 (9th Cir. 1979); Smith v. Pro Football, Inc., 593 F.2d 1173, 1180-81 (D.C. Cir. 1978); Hatley v. American Quarter Horse Ass'n, 552 F.2d 646, 652-54 (5th Cir. 1977); Mackey v. National Football League, 543 F.2d 606, 619 (8th Cir. 1976); Bridge Corp. of America v. The American Contract Bridge League, Inc., 428 F.2d 1365, 1370 (9th Cir. 1970).

[126]Professional football players receive salaries for their services.

of amateurism as a procompetitive justification for the restraint. Preservation of amateurism, or, more accurately, limitations on compensation, are merely a subsidiary means of achieving the NCAA's primary goal of promoting competitive balance and thus ensuring an attractive product for buyers in the college football television market. Promotion of competitive balance is the true procompetitive justification for the NCAA's restraints, including restraints limiting compensation.[127]

C. The NCAA's Television Sanctions Under a Rule of Reason Analysis

If the courts cannot rely on the NCAA's dubious claim of preservation of amateurism as a procompetitive justification for its television sanctions, a rule of reason analysis of the sanctions' standing under section 1 of the Sherman Act becomes a much simpler proposition. The pertinent questions become whether the television bans have an anticompetitive effect within the college football television market, whether the anticompetitive evils of the television sanctions are outweighed by the procompetitive virtue of promoting competitive balance, and whether less restrictive means could be employed by the NCAA to achieve its desired ends.[128]

1. *The Anticompetitive Effects of the NCAA's Television Sanctions.*— The first step in establishing an unreasonable restraint of trade is to show anticompetitive effect.[129] In *Board of Regents*, the district court examined the anticompetitive effects of the NCAA's television plan within the relevant market of live college football television.[130] The Supreme Court agreed with the district court's determination of the relevant market and found that the restraints in the NCAA's television plan had an anticompetitive effect in that they caused individual competitors to lose their freedom to compete,[131] prices were higher and output lower than they would otherwise be, and both price and output were unresponsive to consumer preference.[132]

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[127]It should be noted that the television bans are often imposed for violations of NCAA regulations limiting the compensation payable to athletes. The University of Illinois, the Big 10's 1983 Rose Bowl representative, was prohibited from appearing on television for the 1984 season for violations that included the purchase of airline tickets for prospective players, promises of round-trip airline transportation to Illinois games for the mother of a prospective player, and cash payments to prospective players. The NCAA News, Aug. 1, 1984 at 5, col. 3.

[128]*See infra* notes 129, 137, 142 and accompanying text.

[129]H&B Equipment Co., Inc. v. International Harvester, 577 F.2d 239, 246 (5th Cir. 1978).

[130]546 F. Supp. at 1297-1300.

[131]*See* Fashion Originators' Guild of America v. FTC, 312 U.S. 457, 465 (1941); Standard Sanitary Mfg. Co. v. United States, 226 U.S. 20, 47-49 (1912); Montague and Co. v. Lowry, 193 U.S. 38 (1904).

[132]104 S. Ct. at 2963-64.

An examination of the television sanctions within the same relevant market of college football television reveals many of the same anticompetitive effects as those spawned by the television plan. The television bans are a form of a boycott in which the NCAA members act concertedly to prevent a fellow member institution from competing in the television market. Obviously, any NCAA members who have the television sanctions imposed against them lose their ability to compete within the live college football television market for the duration of the sanctions.

A strong argument can also be made that the television sanctions limit output. The University of Illinois and the University of Southern California, two of the schools which would have been prohibited from appearing on television for the 1984 season if the NCAA had not lifted the suspensions for the year, were both scheduled to appear on national telecasts in 1984.[133] While other games could have been substituted for the games involving USC and the University of Illinois, it is doubtful whether adequate substitutes could have been found for all of the games. For example, the USC-Notre Dame game annually draws national media attention. The two schools are perennial football powers with storied pasts and immense national followings.[134] The task of finding a game of comparable national interest that would be as attractive to viewers and advertisers alike would be difficult, if not impossible. Also, the television plans apply not only to national telecasts but to all telecasts. Under the *Board of Regents* ruling, a team like that of the University of Arkansas, with a strong statewide following and little competition within the state, could enter into a contract with a Little Rock television station to televise its games on a local basis.[135] If Arkansas were placed under an NCAA television sanction, there would be no adequate substitute for the Little Rock television station which had contracted to televise the Arkansas games.

The television sanctions also ignore consumer preference. The NCAA would have prohibited the University of Illinois from appearing on television in 1984 despite the fact that CBS found games involving the University of Illinois to be so attractive as to warrant five regional and three national telecasts during the 1984 season.[136] "A restraint that has the effect of reducing consumer preference in setting price and output is not consistent with the fundamental goal of antitrust law."[137]

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[133]NCAA News, Sept. 17, 1984, at 1, col. 3; Benner, *Big 10 Bows to TV's Dollars*, Indianapolis Star, Aug. 27, 1984, at 21, col. 1.

[134]The University of Notre Dame's games have been telecast on a delayed basis to nearly every major market in the country for the past five seasons and on a live basis during the 1984 season. 1984 NOTRE DAME MEDIA GUIDE.

[135]The Supreme Court endorsed the district court's finding that without the television plan, institutions appealing to essentially local markets would get more television exposure by means of local telecasts. 104 S. Ct. at 2966.

[136]Benner, *Big 10 Bows to TV's Dollars*, Indianapolis Star, Aug. 27, 1984, at 21, col. 1.

[137]104 S. Ct. at 2964.

2. *The NCAA's Procompetitive Justification for the Television Bans.*—The television sanctions cause competitors to lose their freedom to compete within the college football television market, limit output, ignore consumer preference, and therefore have an anticompetitive effect. The next step in the rule of reason analysis of the NCAA's television sanctions is to analyze the NCAA's procompetitive justification for the restraint.

> Under the rule of reason, a restraint must be evaluated to determine whether it is significantly anticompetitive in purpose or effect. . . . If, on analysis, the restraint is found to have legitimate business purposes whose realization serves to promote competition, the "anticompetitive evils" of the challenged practice must be carefully balanced against its "procompetitive virtues" to ascertain whether the former outweigh the latter. A restraint is unreasonable if it has the "net effect" of substantially reducing competition.[138]

As discussed, preservation of amateurism is not a legitimate procompetitive justification for the NCAA's television sanctions. Limitations on compensation are merely another type of restraint, imposed by the NCAA and enforced by the threat of sanctions such as the television bans, designed to further the NCAA's primary goal of competitive balance. Hence, promotion of competitive balance is the "procompetitive virtue" to be balanced against the "anticompetitive evils" of the television bans.

In *Board of Regents*, the Supreme Court recognized promotion of competitive balance as a legitimate procompetitive justification for many of the NCAA's restraints.[139] While the Court went on to find that the television plan was "not even arguably tailored to serve such an interest,"[140] the television sanctions are a means of enforcing NCAA rules and as such can be seen as promoting competitive balance. While the nexus between television bans and promotion of competitive balance seems logical, the assertion of promotion of competitive balance as a procompetitive justification for the television sanctions would still fall under the rationale employed by the Supreme Court in *Board of Regents.*

The Supreme Court in *Board of Regents* also found that "the hypothesis that legitimates the maintenance of competitive balance under the Rule of Reason is that equal competition will maximize consumer demand for the product."[141] In other words, competitive balance is supposed

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[138]Smith v. Pro Football, Inc., 593 F.2d 1173, 1183 (D.C. Cir. 1978).
[139]104 S. Ct. at 2969.
[140]*Id.* at 2970.
[141]*Id.*

to lead to increased consumption. Therefore, restraints promoting competitive balance should also increase consumption. If removal of the restraints would result in increased consumption, the restraints do not promote competitive balance. The Court in *Board of Regents* then found that since consumption would, in fact, increase if the NCAA's television plan were removed, the argument that the plan promoted competitive balance was undermined. The NCAA's television sanctions fall into the same trap when proponents attempt to justify them as a means of promoting competitive balance. In the case of the University of Illinois, removal of the television bans resulted in the sale of the television rights to eight football games. Removal of the bans resulted in increased consumption, just as removal of the television plan was supposed to have resulted in increased consumption. Therefore, promotion of competitive balance can not be viewed as a legitimate justification for the NCAA's television plan.

3. *The NCAA's Television Plan and Less Restrictive Means.*—Even if a court were to find that promotion of competitive balance is a legitimate justification for the television bans, the bans would have to be examined to determine whether other less restrictive means could be employed to achieve the same desired ends.[142] Other sanctions which could be imposed by the NCAA include a reduction of scholarships which could be allotted, prohibition against recruiting athletes, and prohibition from participation in post-season play.[143] These sanctions are clearly sufficient to allow the NCAA to achieve its desired ends of promoting competitive balance, and they do not directly interfere with the NCAA member institutions' ability to participate in the college football television market. A school that has violated NCAA rules designed to promote competitive balance and consequently is punished by having its scholarships taken away, will have a difficult time persuading prospective athletes to attend, regardless

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[142] *Hennessey*, 564 F.2d at 1153.

[143] OFFICIAL PROCEDURE GOVERNING THE NCAA ENFORCEMENT PROGRAM § 7, *reprinted in* [1984-85] MANUAL OF THE NATIONAL COLLEGIATE ATHLETIC ASSOCIATION 204. The fact that nearly all bowl games are televised could lead to the argument that prohibiting post-season appearances is tantamount to prohibiting television appearances. In order to obtain injunctive relief under section 16 of the Clayton Act, the plaintiff would have to show threatened loss due to the alleged antitrust violation. 15 U.S.C. § 26 (1982). Specifically, a school would have to show that but for the NCAA sanctions, its team would go to a bowl game. Unlike television appearances contracts which are entered well before the football season begins, bowl game appearances are not determined until the season is nearly over. In order for the plaintiff school to obtain its desired injunctive relief, it would have to commence its action before the determination of bowl game participants. Therefore, any assertion of antitrust injury in the case of bowl game prohibitions would require speculation as to the probable fortunes of the plaintiff school's football team. The speculative nature of the injury would probably cause the court to find that the plaintiff had no standing to assert a claim of antitrust violations. *See* Justice v. NCAA, 577 F. Supp. 356 (D. Ariz. 1983).

of the number of television appearances the school may have. If the school is unable to attract quality athletes, then the competitive advantage it gained by breaching the rules will gradually be eliminated and competitive balance will be restored, thus preserving the integrity of the product of college football without prohibiting the school from competing in the television football market.

V. Conclusion

The Supreme Court's decision in *NCAA v. Board of Regents of the University of Oklahoma* eliminates the power of the NCAA to impose television sanctions. Under a rule of reason analysis, the television sanctions have significant anticompetitive effect in that they deny competitors the freedom to compete within the market of college football television, they limit output, and they ignore consumer preference. The use by the NCAA of the promotion of competitive balance as a procompetitive justification for the television sanctions would not be accepted by a court employing the rationale of *Board of Regents* because removal of the television sanctions would result in increased consumption within the college football television market.

But the real significance of the *Board of Regents* decision with regards to the NCAA's sanctioning power lies not in the rationale employed, but rather in the depth of the analysis employed to examine the NCAA's procompetitive justifications for its television plan. Rather than simply accepting the NCAA's justifications for its television plan, the Court closely examined each claim to test its validity. Prior to *Board of Regents*, courts faced with antitrust challenges to NCAA restrictions made no such examination when presented with the NCAA's procompetitive justification of preservation of amateurism, but instead accepted the claim on its face. The *Board of Regents* decision calls for a closer inspection, and such an inspection would reveal that the preservation of amateurism is not a valid procompetitive justification for the television bans or any other restraints imposed by the NCAA.

Such an interpretation of *Board of Regents* does not destroy the viability of the NCAA as a sanctioning body for collegiate athletics. Rather, it simply confines the scope of the NCAA's sanctioning power within the realm of the NCAA's true purpose: the promotion of competitive balance. The NCAA does have the power to impose sanctions, but those sanctions must be clearly designed to promote competitive balance, and they must be no broader than necessary to achieve that end.

Default on Foreign Sovereign Debt: A Question for the Courts?

I. Introduction

In the 1980's foreign sovereign debt has emerged as a major international crisis.[1] Never before has sovereign debt owed to commercial banks risen to such a precarious level.[2] The current inability of a number of foreign sovereign debtors to service adequately their debt obligations[3] threatens the stability of both the international monetary system and the American banking system.[4] Debt rescheduling[5] has alleviated the crisis at this stage, yet actual repayment of the debt has only been delayed.[6]

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[1]This is debt incurred by governments or their instrumentalities, particularly the governments of the lesser developed countries. These countries also use government-controlled entities to channel external credits to the private sector. *See* Reisner, *Default By Foreign Sovereign Debtors: An Introductory Perspective*, 1982 U. Ill. L. Rev. 1 (1982).

[2]Barnett, Galvis & Gouraige, *On Third World Debt*, 25 Harv. Int'l. L.J. 83, 83 n.2 (1984). Between 1973 and 1982, the total public and private debt of lesser developed countries increased fivefold, from $109.4 billion to an estimated $529 billion. Comment, *The Renegotiation of Official International Debt: Whose Club Is It*? 17 U.C.D.L. Rev. 853, 854 (1984) [hereinafter cited as Comment, *International Debt*]. The debt total continues to increase, as evidenced by the fact that external Latin American debt has grown an average of thirty percent since 1982. Silk, *Latin Nations' Capital Flight*, N.Y. Times, April 17, 1985, at 26, col. 1.

[3]The 1983 report of the World Bank states that "[m]ost indicators of credit-worthiness showed a serious decline in the ability of developing countries to [pay interest on] their debt." *Developing Countries' Economies Suffered in '83, World Bank Says*, The Indianapolis Star, Sept. 17, 1984, at 15, col. 3. According to reports of the International Monetary Fund, thirty-two countries were in arrears in 1981, as compared to fifteen in 1975. *See* Comment, *International Debt, supra* note 2, at 855 n.7.

[4]Internationally, conflict could result between the capital importing and the capital exporting countries. Declaration of default against one country could create a domino effect, causing other states to default. Barnett, Galvis & Gouraige, *supra* note 2, at 113.

Domestically, an avalanche of defaults, particularly by the major borrowers, could render a number of American banks insolvent. As of June 30, 1980, the debt exposure of the nine largest U.S. banks to the lesser developed countries represented more than 200% of their capital reserves, and the comparable figure for the next fifty largest banks was over 100%. Dod, *Bank Lending in Developing Countries*, 67 Fed. Reserve Bull. 647, 655 (1981).

[5]In a debt rescheduling, the payments under the original obligation are stretched over a longer period. The banks have also extended additional credits to help borrowers overcome short-term liquidity problems. Barnett, Galvis & Gouraige, *supra* note 2, at 84.

[6]As reported by the World Bank, resolution of the liquidity crisis of the early 1980's was achieved through maintenance of the terms on which the debt was originally contracted. Agreements to reschedule have merely pushed back the timetable for payment on the loan principal and have increased the total debt obligations. *Developing Countries' Economies Suffered in '83, World Bank Savs, supra* note 3.

American banks active in the international lending markets have drafted their loan agreements to avail themselves of the jurisidiction of American courts[7] in order to gain judgment in the event of default. The recent decision by the Second Circuit Court of Appeals in *Allied Bank International v. Banco Credito*[8] in favor of an American bank in its default action against three government-controlled Costa Rican banks, who were precluded by actions of the Costa Rican government from making debt payments, suggests that American banks bringing actions in United States courts will obtain favorable results should they resort to judicial enforcement of sovereign loan agreements. The decision indicates that foreign law will not control debt obligations payable in the United States in American currency.[9]

This Note will discuss the issues of jurisdiction and justiciability[10] arising in default actions against foreign sovereign debtors. Although the *Allied Bank* decision indicates otherwise, the courts should closely scrutinize the institutional and foreign policy aspects of cases brought against sovereign debtors. Given the complexity of the international debt crisis, with its enormous foreign policy and domestic economic implications, the courts are presently not the proper forum in which to resolve the debt crisis. Instead, the problem should be comprehensively addressed in the political arena.[11] Explicit policy directives of the political branches could conceivably provide guidelines for the courts to follow in adjudicating default actions by American creditors against foreign sovereign debtors.

II. Foreign Debt: The Nature of the Problem

The spectre of large-scale defaults by foreign sovereign debtors has never loomed so prominently.[12] The last significant default on foreign sovereign debt, which occurred in the 1930's, involved primarily bonds held by individuals and institutions. In this decade a significant amount

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[7]*See generally* Ryan, *Defaults and Remedies Under International Bank Loan Agreements with Foreign Sovereign Borrowers: A New York Lawyer's Perspective*, 1982 U. Ill. L. Rev. 89 (1982).

[8]757 F.2d 516 (2d Cir. 1985), *on reh'g.*

[9]*Id.* at 522.

[10]The issue of justiciability involves the judicially-created act of state doctrine.

[11]Delineation of explicit guidelines to be provided by the political branches is beyond the scope of this Note. This Note will discuss variables which the political branches should address, and which at present militate against judicial resolution of the debt crisis.

[12]*See, e.g.*, *Debtor's Prism*, Economist, Sept. 11, 1982, at 13; Hindle, *A Nightmare of Debt: A Survey of International Banking*, Economist, March 20, 1982, at 54. At present, several of the smaller debtor nations, namely Bolivia, Nicaragua, and Peru, have "for all practical purposes" defaulted. Farnsworth, *New Unease on Debt Crisis*, N.Y. Times, April 15, 1985, at 22, col. 1.

of foreign sovereign debt is in the form of commercial bank lending and therefore has much broader potential impact in the event of widespread defaults.[13]

From the lenders' side, a default action initiated by a creditor unwilling to reschedule could involve the invocation of the ubiquitous cross-default clauses present in sovereign loan agreements.[14] The cross-default clause, which prevents a lender from being placed at a disadvantage among the borrower's creditors,[15] triggers the default clauses in all loan agreements entered into by the troubled borrower.[16] One default declared by a creditor thus has the possible effect of placing all the debtor's loans in default, conceivably necessitating suits by other creditors to protect their interests.[17] This could lead to the potentially disastrous consequence of the creditors being forced to write off the loans.[18]

A suit by a recalcitrant creditor unwilling to renegotiate might in turn lead to declarations of default or outright repudiations by borrowing nations.[19] Debtor cartels[20] could result, leading to the cessation of payments by a number of sovereign debtors. The potential conflict between creditor and debtor nations presents a real threat to an increasingly interdependent international banking system as well as to the solvency of a number of American banks.

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[13]If banks are forced to write off defaulted loans, their asset growth, earnings, and capital position would be adversely affected. A severe contraction of available domestic credit could also result. Comment, *International Debt, supra* note 2, at 856-57 n.15. *See also infra* note 18.

[14]Barnett, Galvis & Gouraige, *supra* note 2, at 113. When the present crisis first arose, it was conjectured that a smaller regional bank with limited international exposure would forego renegotiation of existing debt. This is precisely what occurred in the *Allied Bank* case, in which only one of the thirty-nine members of the banking syndicate appealed the trial court's decision. This possibility is countered, however, by pressure brought to bear on the smaller banks by members of the banking community with greater international debt exposure.

[15]Ryan, *supra* note 7, at 95-96.

[16]Barnett, Galvis & Gouraige, *supra* note 2, at 113.

[17]*Id.* To date, the cross-default clauses have not been invoked.

[18]Upon a declared default, bank regulators require the lender either to increase its loan loss reserves or, to the extent not done so already, write off all or a portion of the loan. Clarke & Farrar, *Rights and Duties of Managing and Agent Banks in Syndicated Loans to Government Borrowers*, 1982 U. ILL. L. REV. 229, 232 (1982). Given the extensive international exposure of a number of American lending institutions, bank failures could result. *See supra* note 4.

[19]A country experiencing domestic economic and political difficulties could opt to defy its creditors and cut itself off from bank credit. This would, of course, be costly to the borrower, who would be, at least in the short term, cut off from commercial lenders. Furthermore, other debtor nations, themselves involved in the renegotiation process, have brought pressure on other borrowers not to repudiate.

[20]It is speculated that upon a default declaration, other borrowing nations would support the defaulting country and default on, or repudiate, their own loans. Recently,

A. The Internationalization of American Banking

Since the late 1960's, American banks have greatly expanded their activities in the international lending markets. In 1967, fifteen American banks had a total of 295 overseas branches and subsidiaries.[21] Ten years later, 130 American banks had 738 foreign branches and subsidiaries.[22] In a decade, the extension of credit to foreign entitites by American commercial banks grew eightfold.[23]

While American banks had previously extended credit primarily to European and other industrialized countries, beginning in the early 1970's the banks began to focus on lesser developed countries, particularly in Latin America.[24] A marked shift from lending to private interests to extending credit to foreign governments and government-controlled entities also ensured.[25] This shift in the nature of foreign lending coincided with the expansion of American banking activity in the virtually unregulated[26] international money markets.

American banks, closely regulated domestically,[27] sought new markets

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a group of Latin American countries with a combined external debt of $330 billion formed a coalition to negotiate with their creditors. The coalition, called the Cartagena Group, is advocating cooperation while at the same time expressing dissatisfaction with protectionist trade practices in the creditor nations and with their lack of input regarding world economic policies. *Debtor-Bank Dialogue*, N.Y. Times, Sept. 15, 1984, at 30, col. 7. As yet, however, no debtor cartels have materialized. Kristof, *Debt Crisis Called All But Over*, N.Y. Times, Feb. 4, 1985, at 25, col. 4.

[21]54 ANN. REP. BD. OF GOVERNORS FED. RES. SYS. 323 (1967).

[22]64 ANN. REP. BD. OF GOVERNORS FED. RES. SYS. 409-410 (1977).

[23]Reisner, *supra* note 1, at 2. In 1970, the total was approximately $50 billion. 58 FED. RESERVE BULL. A 85 (Tables 14, 15), A 88 (Table 21a) (Dec. 1972). By December, 1981, that total had grown to over $400 billion. 68 FED. RESERVE BULL. A 63 (Table 3, 20) (Jan. 1982).

[24]Reisner, *supra* note 1, at 2; *See* Davis, *Banker's Casino: Gambling in the $900 Billion Euromarket*, HARPERS, Feb., 1980, at 43.

[25]Reisner, *supra* note 1, at 3.

[26]This transformation in the banking industry escaped the notice of the industry's state and federal regulators. *Id.* at 1.

> "[N]o single bank regulatory agency, national or international has either the authority or the responsibility to oversee this market. Until recently, the Federal Reserve and the Comptroller of the Currency did not even have comprehensive statistics on the foreign claims and liabilities of the overseas branches of U.S. banks. The activities of banks outside their own borders fall largely between the cracks of individual national bank regulations." *Id.* at 1 n.2, *citing* STAFF OF SENATE SUBCOMM. ON FOREIGN ECONOMIC POLICY OF THE COMM. ON FOREIGN RELATIONS, 95TH CONG., 1ST SESS., INTERNATIONAL DEBT, THE BANKS, AND U.S. FOREIGN POLICY 2 (Comm. Print) (1977).

[27]Regulation D of the Federal Reserve, which requires all banks to hold 10-22% of funds in reserve against domestic liabilities, is not applicable to foreign branches of American banks. Davis, *supra* note 24, at 48-49.

in search of higher profits.[28] The drive for higher profits gained momentum as bankers perceived international expansion as vital to the protection of their share of the banking markets.[29] Profits from international operations soon constituted the majority of the total earnings of the largest participating banks.[30]

This global expansion by American banks was fueled by the infusion of capital stemming from the exponential increases in oil prices and the resultant capital surpluses of the oil-producing countries in the 1970's. This capital, often called "Eurodollars"[31] or "petrodollars," was deposited in the overseas branches of American banks and then lent to the lesser developed nations. Faced with the need for capital for economic development as well as for the increased cost of oil, the non-oil-producing developing nations found access to virtually unconditional loans from American commercial banks,[32] who viewed the sovereign borrowers as good credit risks.[33] By the end of 1982, lesser developed nations owed roughly three hundred billion dollars to commercial banks in the industrialized countries.[34]

B. The Debt Crisis

Economic developments during this same period rendered many sovereign debtors incapable of adequately servicing their newly-acquired

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[28]This was due in part to the absence of regulatory control over the foreign branches and subsidiaries of American banks. *See supra* notes 26-27.

[29]In retrospect, many bankers assert that they were not so much driving to maximize profits as trying to keep their share of markets in the face of intensified competition. Silk, *The Debate About Bailouts*, N.Y. Times, Aug. 3, 1984, at 30, col. 1.

[30]For example, by 1976 these banks' earnings from international operations comprised the following portions of total profits: Citicorp, 72%; Chase Manhattan, 78%; and Manufacturer's Hanover, 65%. Davis, *supra* note 24, at 46.

[31]Stated simply, a Eurocurrency is any currency deposited outside the country of origin. Because there is no direct regulation of the Euromarket, an exact figure is not available, although it is estimated that funds in the Euromarket total at least $2 trillion. Maidenberg, *Eurodollars at Philadelphia*, N.Y. Times, May 13, 1985, at 25, col. 1.

[32]The competitive forces relating to loans to sovereign debtors were frequently unrelated to the borrower's ability to repay the loan. Such loans were syndicated on the basis of relatively little actual credit information concerning the debtor's financial condition. Clarke & Farrar, *supra* note 18, at 231. The massive lending to developing nations was thus based on bank resources rather than the debtors' creditworthiness.

[33]Barnett, Galvis & Gouraige, *supra* note 2, at 84. The bankers perceived the lesser developed nations to be excellent credit risks, primarily based on the assumptions that sovereigns cannot become bankrupt and that there was a greatt likelihood of official relief from the International Monetary Fund and the federal government in the event of a default. *Id.* at 89.

[34]Wallis, *Bankers and the Debt Crisis: An International Melodrama*? 83 DEP'T. ST. BULL. 42 (Oct. 1983). *See supra* note 2 and accompanying text.

external debt obligations. A strong American dollar, high interest rates,[35] budget deficits, and low commodity prices[36] left many borrowing countries unable to service external debt. Creditors have rescheduled existing loans,[37] and in some instances have extended additional credit,[38] although not on the unconditional terms available in the 1970's.[39] In renegotiating, the creditors are requiring assurances, similar to those required by the International Monetary Fund, that the debtor nations institute sound domestic economic policies.[40]

The extent of the sovereign debt crisis goes beyond the fact that actual payment on the original debt obligations has been delayed by rescheduling.[41] Several countries are presently unable to pay even the interest on their rescheduled obligations.[42] A second wave of debt crises may be imminent.[43]

III. Judicial Resolution of Sovereign Defaults: Questions of Jurisdiction and Justiciability

Despite the number of "non-performing" loans, American banks have not utilized the legal system for enforcement of delinquent loan payments by foreign sovereign debtors to any great extent.[44] Whether the banks will do so in the future remains uncertain. In that event, though, a suit brought against a sovereign debtor would present issues of jurisdiction and justiciability.

A. Sovereign Immunity

In a suit brought against a foreign sovereign, the court must first address the issue of sovereign immunity.[45] The doctrine of sovereign

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[35]Increases in interest rates added billions of dollars to debt service costs. N.Y. Times, *supra* note 20, at 30.

[36]The sharp decline in prices in the commodities markets greatly reduced levels of hard-currency income needed to service external debt obligations.

[37]*See supra* notes 5-6 and accompanying text.

[38]The new loans are generally at higher interest rates over longer periods, thus compounding the debtors' liquidity problems. *See supra* note 35.

[39]*See supra* notes 32-33 and accompanying text.

[40]Farnsworth, *America's Hard Line on Aid to Poor Nations*, N.Y. Times, Sept. 27, 1984, at 29, col. 1. The International Monetary Fund, a quasi "bank of last resort," lends money to cash-short countries to pay their international debt obligations, but only if the countries adopt Fund-proposed "austerity programs." Comment, *International Debt*, *supra* note 2, at 869. The programs are aimed at lowering inflation, curtailing imports and wages, cutting social programs, and devaluing currencies.

[41]*See supra* notes 5-6.

[42]*See New Crisis Has Begun in International Debt, Banking Experts Warn*, Wall St. J., June 8, 1983, at 1, col. 6.

[43]Comment, *International Debt*, *supra* note 2, at 857.

[44]Prior to 1982, lender banks had not declared a loan in default except in the case of Iranian credits. Reisner, *supra* note 1, at 6.

[45]Persinger v. Islamic Republic of Iran, 729 F.2d 835, 838 (D.C. Cir. 1984), *on reh'g*.

immunity precludes domestic courts from exercising personal jurisdiction over foreign states.[46] Historically, foreign states enjoyed absolute immunity from being sued in American courts.[47] The courts would dismiss actions against foreign sovereigns for lack of jurisdiction.

In this century, as governments increasingly engaged in commercial activities, a substantial number of states abandoned the absolute theory of sovereign immunity in favor of a restrictive theory of immunity.[48] In 1952 the United States, where a unique practice had emerged in which the State Department became the final arbiter on the question of sovereign immunity,[49] adopted the restrictive theory of immunity.[50] Sovereign immunity was recognized with respect to public acts of state, but not with respect to private, or commercial, acts.[51] American courts, upon the advisement (or silence) of the Department of State, could thus exercise jurisdiction in cases arising out of commercial transactions.

In 1976 Congress enacted the Foreign Sovereign Immunities Act (FSIA).[52] The FSIA codified the rule for jurisdiction over foreign sovereigns and their instrumentalities,[53] thus removing the discretion previously exercised by the executive branch. The issue of sovereign immunity became a question of statutory subject matter jurisdiction, the determination of which was vested solely with the courts.

Generally, under the FSIA, foreign states are immune from the jurisdiction of American courts.[54] The Act provides, however, for ex-

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[46]The doctrine has its roots in the 19th century notion, as set forth by Chief Justice Marshall in *The Schooner Exchange v. McFaddon*, that sovereigns are not presumed without explicit declaration to have opened their tribunals to suits against other sovereigns. 11 U.S. (7 Cranch) 116, 146 (1812).

[47]*See* Ricaud v. American Metal Co., 246 U.S. 304 (1918); Oetjen v. Central Leather Co., 246 U.S. 297 (1918); Underhill v. Hernandez, 168 U.S. 250 (1897); *see also* Crockett, *Choice of Law Aspects of the Foreign Sovereign Immunities Act of 1976*, 14 LAW & POL'Y IN INT'L BUS. 1041, 1043 (1983).

[48]Alfred Dunhill of London, Inc. v. Cuba, 425 U.S. 682, 702 n.15 (1976).

[49]*See* Republic of Mexico v. Hoffman, 324 U.S. 30 (1945); *Ex parte* Republic of Peru, 318 U.S. 578 (1943); *see also* Isbrandtsen Tankers, Inc. v. President of India, 446 F.2d 1198 (2d Cir.), *cert. denied*, 404 U.S. 985 (1971) (if State Department suggested immunity judiciary would not interfere).

[50]In the famous "Tate Letter," written by the Acting Legal Advisor of the Department of State to the Attorney General, it was indicated that the Department of State would henceforth follow the restrictive theory of sovereign immunity in its consideration of requests by foreign governments for a grant of sovereign immunity. The letter stated that according to the restrictive theory, the immunity of the sovereign is recognized with regard to public (*jure imperio*) acts of state, but not with respect to private acts (*jure gestionis*). 26 DEPT. OF STATE BULL. 984 (1952).

[51]*Id.* The private activities discussed in the Tate Letter were acts commercial in nature, or acts which an individual might engage in for profit. *See, e.g.*, Texas Trading & Milling Corp. v. Federal Rep. of Nigeria, 647 F.2d 300, 309 (2d Cir. 1981) (if activity one in which a private party could engage, sovereign not entitled to immunity).

[52]28 U.S.C. §§ 1330; 1332(a)(2)-(4); 1391(f); 1441(d); and 1602-1611 (1982).

[53]28 U.S.C. § 1602 (1982).

[54]*Id.* at § 1604.

ceptions to jurisdictional immunity,[55] and has adopted the restrictive theory of immunity.[56] In addressing the question of whether a sovereign act should be deemed a commercial activity and thus subject to the court's jurisdiction, the courts are instructed to look at the nature, rather than the purpose, of the activity in question.[57]

The FSIA expressly provides for jurisdiction in many cases that would not have been legitimate before its enactment.[58] Prior to passage of the Act, at least one court had expressed the view that sovereign loans were public, rather than commercial, acts.[59] Under the FSIA, the courts will be able to assume subject matter jurisdiction in default actions against foreign sovereigns who have executed loan agreements with American commercial banks. As stated, such loan agreements generally contain express waivers of sovereign immunity.[60] Even absent such a waiver, the legislative history of the FSIA indicates that borrowing by foreign sovereigns should be deemed a commercial activity, permitting a court to exercise jurisdiction.[61]

B. Act of State Doctrine

In a default action brought against a foreign sovereign debtor, a court with proper statutory jurisdiction may nevertheless decline to address the merits of the case by invoking the judicially-created act of state doctrine, which was unaffected by the enactment of the FSIA.[62] The act of state doctrine represents an exception to the general rule that courts of the United States with appropriate jurisdiction will decide cases by choosing the rules appropriate for decision from among the various sources of law.[63] Abstention on act of state grounds has been analogized

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[55]*Id.* at §§ 1605-07.

[56]*See* Puggerio v. Compania Peruana De Vapores, 639 F.2d 872 (2d Cir. 1981) (important goal of FSIA was codification of restrictive theory of immunity).

[57]28 U.S.C. § 1603(d) (1982).

[58]Crockett, *supra* note 47, at 1042.

[59]Victory Transport, Inc. v. Comisaria Gen., 336 F.2d 354, 360 (2d Cir. 1964), *cert. denied*, 347 U.S. 934 (1965). *See* Nichols, *The Impact of the Foreign Sovereign Immunities Act on the Enforcement of Lenders' Remedies*, 1982 U. ILL. L. REV. 251, 253 (1982).

[60]*See supra* note 7. Pursuant to 28 U.S.C. § 1605(a)(1), a foreign sovereign is not immune when it has waived its immunity either explicitly or by implication.

[61]"Activities such as a foreign government's . . . borrowing of money . . . would be among those included within the definition of commercial activity." H. R. REP. No. 94-1187, 94th Cong., 2d Sess. 28, *reprinted in* 1976 U.S. CODE CONG. & AD. NEWS 6604, 6627.

[62]*See, e.g.*, Empresa Cubana Exportadora v. Lamborn & Co., Inc., 652 F.2d 231, 238-39 n.11 (2d Cir. 1981) (even where defense of sovereign immunity not applicable, act of state doctrine may prevent recovery); Braka v. Bancomer, S.A., 589 F. Supp. 1465 (S.D.N.Y. 1984) (that defendant not immune does not mean court should proceed to adjudicate plaintiff's claim).

[63]First Nat'l. City Bank v. Banco Nacional de Cuba, 406 U.S. 759, 763 (1972). *See* The Paquete Habana, 175 U.S. 677 (1900).

to the posture taken with respect to political questions.[64]

Arising in conjunction with the doctrine of sovereign immunity,[65] although itself not jurisdictional,[66] the act of state doctrine reflects the reluctance of the courts to pass judgment on the actions of foreign sovereigns.[67] The doctrine had its historical roots in the "highest notions of comity."[68] Similar to the absolute immunity enjoyed by foreign sovereigns, the act of state doctrine created a presumption of non-justiciability in addressing the legal validity of acts of foreign sovereigns.[69]

In *Banco Nacional de Cuba v. Sabbatino*,[70] the seminal contemporary United States Supreme Court case involving the act of state doctrine, the Court found the doctrine to be rooted not in notions of international comity but in the separation of powers in the federal government.[71] The Court was faced with a claim arising from an action of the Cuban government that resulted in the expropriation of American property.[72] Declining to pass on the legality of the Cuban act of state, the Court declared that it would not inquire into the validity of the public acts of a foreign sovereign committed within its own territory.[73]

The Court stated that while the text of the Constitution does not require the act of state doctrine,[74] the doctrine has " 'constitutional' underpinnings" arising out of the basic relationship between the branches of the federal government,[75] and "concerns the competency of dissimilar

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[64]*See infra* note 71.

[65]406 U.S. at 762. The separate line of cases enunciating both the act of state doctrine and the doctrine of sovereign immunity has a common source in *The Schooner Exchange*, 11 U.S. at 116. *Id.*

[66]Act of state is a prudential doctrine designed to avoid judicial action in sensitive areas. International Ass'n of Machinists and Aerospace Workers v. OPEC, 649 F.2d 1354, 1359 (9th Cir. 1981), *cert. denied*, 454 U.S. 1136 (1982), citing Ricaud v. American Metal Co., 246 U.S. at 309.

[67]The classic statement of the doctrine was set forth by Chief Justice Fuller in Underhill v. Hernandez, 168 U.S. 250, 252 (1897):

> Every sovereign State is bound to respect the independence of every other sovereign State, and the courts of one country will not sit in judgment on the acts of the government of another done within its own territory. Redress of grievances by reason of such acts must be obtained through the means open to be availed of by sovereign powers as between themselves.

[68]406 U.S. at 762. *See also* Oetjen v. Central Leather Co., 246 U.S. at 304.

[69]168 U.S. at 250. *See* Note, *Rehabilitation and Exoneration of the Act of State Doctrine*, 12 N.Y.U.J. INT'L. LAW & POLITICS 599 (1977) [hereinafter cited as Note, *Rehabilitation*].

[70]376 U.S. 398 (1964).

[71]*Id.* at 423. Subsequently, Justice Brennan stated that *Sabbatino* held that the issue of the validity of a foreign act of state in certain circumstances is a "political question" not cognizable in our courts. 406 U.S. at 787-88 (Brennan, J., dissenting). *See* L. TRIBE, AMERICAN CONSTITUTIONAL LAW, 76-78 n.5 (1978).

[72]376 U.S. at 400-01.

[73]*Id.* at 428.

[74]*Id.* at 423.

[75]*Id.* The doctrine's "continuing validity" depends on its capacity to reflect the

institutions to make and implement particular kinds of decisions in the area of international relations."[76] Rather than establishing an "inflexible and all-encompassing rule" regarding judicial application of the act of state doctrine, the Court called for a "balance of relevant considerations" in each case.[77]

Despite the extensive analysis of the doctrine in that case, *Sabbatino* has done little to clarify the scope of the act of state doctrine.[78] A great deal of confusion continues to surround its application.[79] The courts have been inconsistent in their interpretation and application of the doctrine, due in part to uncertainty as to the courts' relationship to the political branches and as to the appropriate weight to be accorded to the various interests involved in the litigation.[80]

The type of balancing dictated by *Sabbatino*[81] requires the courts to address a number of factors in deciding whether to invoke the act of state doctrine. The principal factors to be considered include whether the applicable principles of international law are ambiguous in nature, whether the challenged governmental conduct was public rather than commercial in nature, whether the purpose of the act of state was to serve an integral governmental function, and whether the executive branch has addressed the validity of the act in question.[82]

While the FSIA instructs the courts to look only at the nature of the foreign state's action,[83] act of state doctrine analysis involves addressing the underlying purpose of the questioned conduct. A distinction has emerged between public and commercial purposes of the governmental act at issue, centering on whether the act constitutes an exercise of the state's sovereignty in addressing public concerns.[84] Where a sovereign has acted in a "public" capacity in addressing national concerns, courts have invoked the act of state doctrine in declining to adjudicate the legal validity of the sovereign's conduct.[85]

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proper distribution of functions between the judicial and political branches on matters bearing upon foreign affairs. *Id.* at 427-28.

[76]376 U.S. at 423.

[77]*Id.* at 428.

[78]Crockett, *supra* note 47, at 1055.

[79]*Id.*

[80]*See generally* Kleinman, *The Act of State Doctrine — From Abstention to Activism*, 6 J. OF COMP. BUS. & CAP. MKT. LAW 115 (1984).

[81]"The balancing of interests, recognized as appropriate by *Sabbatino*, requires a careful examination of the facts in each case and of the position, if any, taken by the political branches of government." 406 U.S. at 774 (Powell, J., concurring).

[82]Texas Trading, 647 F.2d at 316 n. 38.

[83]International Ass'n of Machinists and Aerospace Workers v. OPEC, 649 F.2d at 1360. *See also supra* note 57 and accompanying text.

[84]649 F.2d at 1360 (when state *qua* state acts in public interest, its sovereignty is asserted).

[85]*See id.* at 1361; Hunt v. Mobil Oil Corp., 550 F.2d 68, 73 (2d Cir.), *cert. denied*,

In a default action against a foreign sovereign debtor, there may be two sovereign acts involved, as was the case in the *Allied Bank*[86] litigation. The first act would be the contracting of a loan obligation with a syndicate of commercial banks. This act clearly would have been undertaken for a commercial purpose.

The second governmental act may be the exercise of a national policy affecting the servicing of external debt obligations. A policy constricting or precluding debt servicing in response to an economic crisis would be undertaken for the purpose of regulating the sovereign's domestic economy. The sovereign would be acting in a "public" capacity in addressing national economic concerns.[87]

Actions affecting a sovereign's economy are likely to have a strong bearing on foreign affairs.[88] Judicial review of such public acts of state could result in the worsening of United States relations with the sovereign as well as embarrassment of the political branches in their conduct of foreign relations.[89] Invocation of the act of state doctrine would alleviate the necessity of the court's determining the legal validity of a public sovereign act undertaken with the purpose of serving an integral governmental function. Such was the reasoning of the district court in *Allied Bank*,[90] although its decision was ultimately reversed on appeal.[91]

IV. *Allied Bank International v. Banco Credito*

Allied Bank International v. Banco Credito[92] represents the first case pressed to judgment since the onset of the foreign sovereign debt crisis.[93] The case is particularly significant given the paucity of litigation involving the question of default on sovereign loan obligations.[94] Its significance is increased by the fact that the majority of cases involving the act of state doctrine are decided by the Second Circuit Court of Appeals[95] and because many of the sovereign loan agreements, syndicated by New York banks, contain provision for payment in New York.

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434 U.S. 984 (1977); Timberlane Lumber Co. v. Bank of America, 549 F.2d 597, 607 (9th Cir. 1976). *See also* Note, *Judicial Balancing of Foreign Policy Considerations: Comity and Errors Under the Act of State Doctrine*, 35 STAN. L. REV. 327 (1983) [hereinafter cited as Note, *Judicial Balancing*].

[86]757 F.2d 516.

[87]*See supra* notes 84-85 and accompanying text.

[88]Note, *Judicial Balancing*, *supra* note 85, at 340.

[89]*See* 406 U.S. at 765.

[90]Allied Bank Int'l. v. Banco Credito, 566 F. Supp. 1440, 1444 (S.D.N.Y. 1983), *rev'd*, 757 F.2d 516 (2d Cir. 1985).

[91]*Allied Bank*, 757 F.2d at 523.

[92]757 F.2d 516 (2d Cir. 1985).

[93]Nat'l. L.J., May 14, 1984, at 3.

[94]*See supra* note 44 and accompanying text.

[95]Note, *Rehabilitation*, *supra* note 69, at 637.

The action[96] was brought originally by the agent bank for a syndicate of thirty-nine banks[97] against three Costa Rican banks owned by the Republic of Costa Rica and subject to the control of the Central Bank of Costa Rica. In 1976 the three defendant Costa Rican banks executed a series of promissory notes payable to the syndicate banks in United States currency in New York. Required payments on the notes, due every six months commencing July 1, 1978, through July, 1983, were made on schedule until 1981.[98]

In that year the Costa Rican government, in response to a serious economic crisis, imposed restrictions upon foreign exchange transactions. One such restriction required approval by the Central Bank of Costa Rica of any foreign exchange transactions by Costa Rican banks. On July 2, 1981, defendant Banco Cartago applied to the Central Bank for authorization to make its payment due on July 1 to the syndicate banks.[99]

The following month the Central Bank's Board of Directors passed a resolution prohibiting public sector entities such as the defendant banks from paying any interest or principal denominated in foreign currency on debts to foreign creditors. On November 6, 1981, the President and Ministry of Finance published a decree preventing any institution in Costa Rica from making external debt payments without prior approval of the Central Bank in consultation with the Ministry of Finance. Three days later the Central Bank denied Banco Cartago's pending application for foreign exchange.[100]

Each of the defendant banks was subsequently notified that it would not be permitted to make external debt payments pending resolution of the entire Costa Rican external debt situation. Further payments on the promissory notes were thus effectively blocked. Allied Bank, on behalf of the other syndicate banks, filed suit in the United States District Court for the Southern District of New York to invoke the applicable acceleration clauses in the loan agreements and to recover the balances[101] with accrued interest.[102]

The district court concluded that the act of state doctrine, raised by the defendants in opposition to Allied's motion for summary judg-

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[96]Allied Bank Int'l. v. Banco Credito Agricola de Cartago, 566 F. Supp. 1440 (S.D.N.Y. 1983), *rev'd*, 757 F.2d 516 (2d Cir. 1985).

[97]Two of the named plaintiffs were American Fletcher National Bank of Indianapolis and American Fletcher (Suisse) A.G. 566 F. Supp. at 1440.

[98]*Id.* at 1442.

[99]*Id.*

[100]*Id.*

[101]For the three defendant banks, the total unpaid principal balances totalled approximately $4.5 million. *Id.*

[102]566 F. Supp. at 1442.

ment,[103] dictated the denial of Allied's motion.[104] In its analysis, the court readily disposed of the sovereign immunity issue raised by the defendants. The court found that it was quite clear that the execution of the promissory notes was a commercial activity within the meaning of the FSIA.[105]

Conceding that the action was premised on a commercial activity within the meaning of the statute, the court then stated that "a different question arises by virtue of the fact that the payment of the notes *was prevented* by certain directives of the Central Bank of Costa Rica, and of the President and Ministry of Finance of that country."[106] The crux of that question was whether the governmental acts preventing payment of the notes fell within the act of state doctrine.[107]

The court noted that the act of state doctrine, designed to avoid judicial action which would impinge upon the foreign relations of the United States, may prevent recovery even where the defense of sovereign immunity does not apply.[108] To the court, the crucial factor was that the conduct of the Costa Rican government which prevented payment of the notes, undertaken in response to a serious national economic crisis,[109] was public, rather than commercial, in nature.[110] There was no doubt either that the actions of the Costa Rican government were intended to serve a public purpose or that the actions were an exercise of a governmental function. The court concluded that:

> A judgment in favor of Allied in this case would constitute a judicial determination that defendants must make payments contrary to the directives of their government. This puts the judicial branch of the United States at odds with policies laid down by a foreign government on an issue deemed by that government to be of central importance. Such an act by this court risks embarrassment to the relations between the executive branch of the United States and the government of Costa Rica.[111]

While the action was still pending before the district court, the parties began to negotiate a rescheduling of the defendants' loan obli-

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[103]There was no question that the defendant banks had defaulted on the debts due to Allied and the other syndicate banks. *Id.*

[104]566 F. Supp. at 1444.

[105]*Id.* at 1443.

[106]*Id.* (emphasis in original).

[107]*Id.*

[108]*Id.*

[109]*Id.* "[T]hese actions were of the type which some governments undertake to try to assist in such a crisis — i.e., restrictions upon foreign currency transactions." *Id.*

[110]566 F. Supp. at 1443.

[111]*Id.* at 1444.

gations.[112] In July, 1983, the suit was dismissed by agreement of the parties. In September the defendants, the Central Bank, and the Republic of Costa Rica signed a refinancing agreement. One of the syndicate banks[113] did not accept the new agreement, and Allied appealed on its behalf. The refinancing nevertheless went into effect and the Costa Rican banks made payments to the other members of the syndicate.[114]

The Second Circuit Court of Appeals reversed both the district court's dismissal of the cause and the denial of Allied's motion for summary judgment.[115] The court also vacated its earlier decision which had affirmed the district court.[116] Finding the act of state doctrine to be inapplicable, the Second Circuit remanded to the district court for entry of summary judgment in favor of Allied.[117]

In its previous decision affirming the district court, the Second Circuit had not addressed the question of whether the act of state doctrine applied, but had instead concluded that principles of comity compelled it to recognize as valid the Costa Rican directives which prevented payment of the loan obligations.[118] The court had determined that the actions of the Costa Rican government which precipitated the default "were fully consistent with the law and policy of the United States."[119] Its interpretation of United States policy arose primarily from the court's belief that the legislative and executive branches of the American government had fully supported Costa Rica's actions and all of the economic ramifications.[120]

On rehearing, the executive branch joined the litigation as *amicus curiae* and disputed that reasoning. In its brief the government expressed its support of the debt resolution procedure of the International Monetary Fund that encourages cooperative adjustment of international debt problems. The government explained that the procedure is grounded in the understanding that while the parties may agree to renegotiate conditions of payment, the underlying obligations remain valid and enforceable. The government contended that Costa Rica's attempted unilateral restructuring of private obligations was inconsistent with this system of

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[112]757 F.2d at 519.

[113]Fidelity Union Trust Company of New Jersey was the only creditor who refused to participate in the restructuring. *Id.*

[114]757 F.2d at 519.

[115]*Id.* at 518.

[116]The earlier decision, dated April 23, 1984, was reported in the advance sheets; however, the Second Circuit, upon granting rehearing, vacated the opinion, which does not appear in the bound volume of the Federal Reporter. *See* Allied Bank Int'l v. Banco Credito, 733 F.2d 23 (2d Cir. 1984).

[117]757 F.2d at 518.

[118]*Id.* at 519.

[119]*Id.*

[120]*Id.*

international cooperation and negotiation and thus inconsistent with United States policy.[121]

The government further explained that its position on private international debt was not inconsistent with either the executive branch's willingness to restructure Costa Rica's intergovernmental loan obligations or with the continued approval by Congress of foreign aid to that economically distressed Central American country.[122] The court, stating that its previous conclusion that the Costa Rican decrees were consistent with United States policy was premised on those two circumstances, expressed its belief that, in light of the goverment's elucidation of its position, its earlier interpretation of United States policy had been wrong.[123]

The court nevertheless addressed the issue of the act of state doctrine which, if applicable, would preclude judicial examination of the Costa Rican decrees.[124] The court stated that it "has always been clear" that the doctrine does not bar inquiry by the courts into the validity of extraterritorial takings.[125] Because the court was not prevented from inquiring into the validity of an attempted extraterritorial confiscation, pursuant to the territorial limitation on the act of state doctrine, it determined that its decision depended "on the situs of the property at the time of the purported taking."[126]

The court concluded that because the situs of the property, Allied's right to receive payment in accordance with the loan agreements, was in the United States, the act of state doctrine was not applicable.[127] The court explained that the situs of a debt for act of state purposes depends in large part on whether the purported taking can be said to have " 'come to complete fruition within the dominion of the (foreign) government.' "[128] Because Costa Rica could not wholly extinguish the defendants' obligation to timely pay United States dollars to Allied in New York, the situs of the debt was not Costa Rica.[129]

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[121] *Id.*

[122] *Id.* at 520.

[123] *Id.*

[124] *Id.*

[125] *Id.* (citing Banco Nacional de Cuba v. Chemical Bank, 658 F.2d 903, 908 (2d Cir. 1981) and Republic of Iraq v. First Nat'l. City Bank, 353 F.2d 47, 51 (2d Cir. 1965), *cert. denied*, 382 U.S. 1027 (1966)).

[126] 757 F.2d at 521. The prevention of payment was deemed to be tantamount to an expropriation. "It seems clear that if the decrees are given effect and Allied's right to receive payment in accordance with the agreement is thereby extinguished, a 'taking' has occurred." *Id.* at 521 n.3.

[127] *Id.* at 522.

[128] *Id.* (citing Tabacalera Severiano Jorge, S.A. v. Standard Cigar Co., 392 F.2d 706, 715-16 (5th Cir.), *cert. denied*, 393 U.S. 924 (1968)).

[129] 757 F.2d at 521.

The court further stated that "[t]he same result obtains under ordinary situs analysis."[130] In support of that conclusion, the court set forth policy reasons focusing on United States interests. These interests included maintaining New York as one of the foremost commercial centers in the world and as the international clearing center of United States dollars and ensuring that creditors entitled to payment under contracts subject to the jurisdiction of the United States may assume that, except under the most extraordinary circumstances, their rights will be determined in accordance with recognized principles of contract law.[131]

The court contrasted those interests to Costa Rica's. While recognizing Costa Rica's legitimate concern in overseeing the debt situation of state-owned banks and in maintaining a stable economy, it determined Costa Rica's interest in the contracts at issue to be limited to the extent to which it could unilaterally alter the payment terms.[132] Under either analysis, the situs of the debt was the United States, not Costa Rica; therefore, the act of state doctrine was inapplicable.[133]

Declaring that it had "come full circle to reassess whether we should give effect to the Costa Rican directives," the court determined that it should not.[134] It could do so only if the Costa Rican acts, which fell outside the act of state doctrine because they purported to have extraterritorial effects, were consistent with the law and policy of the United States.[135] The court found the Costa Rican acts to be inconsistent with the orderly resolution of international debt problems and inimical to the interests of the United States, a major source of private international credit. Recognition of the directives would also be counter to principles of contract law.[136] Because the directives were inconsistent with the law and policy of the United States, the court refused to hold that the governmental acts excused the obligations of the Costa Rican banks.[137]

Before discussing the implications of the *Allied Bank* litigation, mention should be made of another default case arising out of an almost identical fact situation and filed in the same district court. In *Libra Bank v. Banco Nacional de Costa Rica*,[138] the defendant was prevented

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[130]*Id.*

[131]*Id.* at 521-22.

[132]*Id.* at 522.

[133]*Id.*

[134]*Id.*

[135]*Id.* (citing United States v. Belmont, 301 U.S. 324, 332-33 (1937); *Banco Nacional*, 658 F.2d at 908-09; *Republic of Iraq*, 353 F.2d at 51).

[136]757 F.2d at 522.

[137]*Id.*

[138]570 F. Supp. 870 (S.D.N.Y. 1983). The opinion, in which the court reached a conclusion opposite to that of the district court in *Allied Bank*, was handed down only a matter of days after that decision. *See* Note, *Act of State: Foreign Defaults in Domestic Courts*, 25 HARV. INT'L L.J. 195 (1984) [hereinafter cited as Note, *Act of State*].

by the 1981 directives of the Costa Rican government from making loan payments to the plaintiff banking syndicate. Rejecting the defendant's contention that the governmental directives constituted a defense under the act of state doctrine, the court granted the plaintiffs' motion for summary judgment.[139]

The court recognized what it termed the "territorial corollary" to the act of state doctrine as an important limitation on the preclusive scope of the doctrine.[140] "Unless the expropriation occurs within the foreign state, this court is free to inquire into the validity of the acts of the foreign nation."[141] The court held that the situs of the debt was in New York at the time of the attempted confiscation[142] by the Costa Rican government, thereby making the act of state doctrine inapplicable.[143]

Because the act of state doctrine did not apply, the court was free to examine the validity of the Costa Rican decrees and would give effect to those acts of state only if they were consistent with the policy and law of the United States.[144] The court then further held that it would not give effect to the decrees "since a foreign state's effective confiscation of property, without compensation, is repugnant to the Constitution and laws of this nation."[145] While "not unmindful that the effect of its judgment is to reverse the Costa Rican decrees,"[146] the court reasoned that because its judgment was unlikely to vex the peace of nations, it was not necessary to defer to the foreign affairs competence of the political branches.[147]

In support of its reasoning, the court noted that the underlying notion embodied in the territorial limitation on the act of state doctrine is that courts will vex this country's relations with foreign governments only when they act to frustrate the foreign nation's reasonable expectations of dominion over the property at issue.[148] By limiting its analysis to the territorial limitation on the act of state doctrine, with the resultant assumption that the judgment would not hinder the conduct of foreign

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[139]570 F. Supp. at 896.

[140]*Id.* at 877. "Under *Sabbatino's* formulation, the act of state doctrine forecloses judicial inquiry into the validity of foreign seizures only when there is '*a taking of property within its own territory by a foreign sovereign government.*' " *Id.* (citing *Sabbatino*, 376 U.S. at 428 (court's emphasis)).

[141]570 F. Supp. at 877.

[142]Costa Rica's attempt to extinguish the plaintiffs' legal right to repayment of the debt was deemed by the court to be an attempted confiscation of property. *Id.* at 882.

[143]570 F. Supp. at 882.

[144]*Id.* (citing *Republic of Iraq*, 353 F.2d at 51).

[145]570 F. Supp. at 882.

[146]*Id.*

[147]*Id.*

[148]*Id.* at 883-84. *See* United Bank, Ltd. v. Cosmic Int'l, Inc., 542 F.2d 868, 875 (2d Cir. 1976).

relations, the court failed to address the possibility of embarrassing the political branches of the government which, as recognized by the Second Circuit in *Allied Bank*, had apparently taken a favorable position toward the plight of Costa Rica in its economic crisis.[149] The court accorded little weight to the public purpose for which the Costa Rican government had acted, the crucial factor in the lower court's determination in *Allied Bank*.[150] The conflicting district court decisions in *Libra Bank* and *Allied Bank* thus exemplify the confusion surrounding judicial application of the act of state doctrine.[151]

The Second Circuit's decision in *Allied Bank*[152] would appear to create a broadly applicable precedent for any default action involving sovereign loan obligations payable in American currency in the United States. The circumstances presented in that case, involving a governmental act intended to regulate foreign exchange transactions in the face of a severe economic crisis and a good faith attempt to renegotiate the affected loan obligations, could arguably be distinguished from circumstances in which a foreign sovereign engaged in an outright repudiation of its debt obligations. It must be presumed, however, that regardless of the underlying purpose of a sovereign debtor's act resulting in a default, the act would not be given effect in American courts.[153]

Given the far-reaching foreign policy and domestic economic ramifications of the current debt crisis, the competence of the courts to effect an orderly resolution of the debt crisis is called into question.[154] The Second Circuit was cognizant of the position taken by the political branches vis-à-vis Costa Rica in ruling in the defendant banks' favor on grounds of comity in its original decision.[155] Faced with the government's elucidation of its position, on rehearing the court, candidly admitting it had wrongly interpreted the "political signals" of the political branches, understandably had little choice but to find the Costa Rican acts of state to be inconsistent with United States law and policy.[156]

It is interesting to hypothesize what the executive branch's position[157]

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[149]757 F.2d at 519.

[150]566 F. Supp. at 1443-44.

[151]*See supra* note 80 and accompanying text.

[152]757 F.2d 516.

[153]The Second Circuit did allude to the possibility that "under the most extraordinary circumstances" a United States court would not apply American substantive law as its rule of decision. *Id.* at 521-22. It is uncertain what those extraordinary circumstances might entail.

[154]One commentator has concluded that the lower federal courts, absent a clear statement by the Supreme Court regarding the constitutional underpinnings of the act of state doctrine, are increasingly drawn into judging economic disputes beyond their constitutional competence. Kleinman, *supra* note 80, at 116.

[155]757 F.2d at 519.

[156]*Id.* at 522.

[157]In act of state cases, any position articulated by the executive branch is not controlling

would be in the event, however unlikely, that an American creditor unwilling to renegotiate with a major sovereign debtor brought a default action in a United States court. The loan obligations of the *Allied Bank* defendants[158] were *de minimis* in comparison with the huge external debt obligations of the major Latin American countries. In light of the position presented to the appellate court in *Allied Bank*,[159] it would be logically consistent to assume that the executive branch would view *any* attempted unilateral alteration of external debt obligations to be inconsistent with the accepted debt resolution procedure and therefore inconsistent with American policy.

Regardless of the position of the executive branch, however, the ultimate decision as to the justiciability of the merits of a default action rests solely with the courts.[161] Act of state doctrine concerns include addressing the institutional limitations of the judiciary in adjudicating politically sensitive international disputes and the possibility of affronting foreign states.[162] Yet limiting the scope of that doctrine under the territoriality corollary[163] will allow the courts to address the merits of any case in which debt payments due in this country are prevented by a public act of the sovereign debtor.

V. Execution of a Default Judgment

In the event that a commercial bank gains a judgment in a default action, the problem of executing on the judgment would remain. Reciprocal enforcement of the judgment in a court sitting in the country against which the judgment was entered would presumably be virtually impossible. The possibility of actual recovery on such a judgment would hinge on the ability of the plaintiff to attach the defendant's assets located within the United States.[164]

Because it is likely that a creditor's declaration of default, or even the threat of such action,[165] would prompt the sovereign borrower to

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on the court; whether to apply the doctrine is always a judicial question. *See id.* at 521 n.2. In *First National City Bank*, 406 U.S. at 759, six members of the Court rejected the adoption of the so-called "Bernstein exception" to the doctrine, which purported to allow the executive branch to offer an advisement as to the doctrine's applicability. "The task of defining the contours of a political question such as the act of state doctrine is exclusively the function of this Court." *Id.* at 790 (Brennan, J., dissenting).

[158]The unpaid principal balances totalled approximately $4.5 million. 566 F. Supp. at 1442.

[159]*See* 757 F.2d at 519-20.

[160]*Id.* at 519.

[161]*See supra* note 157.

[162]*See* International Ass'n of Machinists and Aerospace Workers, 649 F.2d at 1360.

[163]One commentator has suggested this to be a formalistic limitation on the scope of the doctrine. *See* Note, *Act of State*, *supra* note 138, at 200.

[164]*See* Nichols, *supra* note 59, at 258.

[165]Peru, worried that its assets deposited in American banks might be vulnerable, has

remove its assets in the United States in order to avoid attachment, the creditor would most likely seek a prejudgment attachment of those assets in an attempt to prevent removal. This scenario was presented in the *Libra Bank*[166] case. Libra Bank had attached assets in the defendant's New York bank accounts under a state court attachment obtained prior to removal of the case to federal court.[167] The district court rescinded that attachment order, finding that the defendant had not waived its immunity to prejudgment attachment.[168]

On interlocutory appeal the decision was reversed,[169] the Second Circuit Court of Appeals holding that Costa Rica had waived any objection to prejudgment attachment.[170] When the plaintiffs subsequently sought to reattach the assets, they discovered the defendant had transferred all of its assets out of New York.[171] Rejecting the plaintiff's request, premised on the defendant's alleged misrepresentations that it could not transfer its assets, for an extraordinary writ to compel the plaintiffs to return the assets, the district court noted that the plaintiffs had failed to show that the defendant had deceived the court into vacating the attachment. The court also noted the plaintiffs could have sought a restraining order to prevent the defendant from transferring its assets.[172]

The FSIA provides exceptions[173] to the general provision in the Act that the property of a foreign state located in the United States will be immune from attachment and execution.[174] A foreign sovereign's property used for a commercial activity[175] in this country will not be immune from attachment if the foreign state has waived its immunity.[176] The loan agreements executed by sovereign debtors often contain clauses waiving immunity from attachment of the sovereign's assets located in the United States.[177]

Attachment of a foreign sovereign's assets would have both political

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withdrawn its deposits from American banks to which it is indebted and has moved the assets into French banks. Kristof, *supra* note 20, at 38, col. 1.

[166]570 F. Supp. at 870.

[167]*Id.* at 885.

[168]*Id.*

[169]Libra Bank Ltd. v. Banco Nacional de Costa Rica, 676 F.2d 47, 48 (2d Cir. 1982).

[170]*Id.* at 49. *See* 28 U.S.C. § 1610(d)(1) (1982).

[171]570 F. Supp. at 585.

[172]*Id.*

[173]28 U.S.C. §§ 1610, 1611 (1982).

[174]*Id.* at § 1609.

[175]This language raises a question in the context of a default case, as normally there would be no property specifically used by the foreign state in connection with a borrowing of money. Ryan, *supra* note 7, at 126.

[176]28 U.S.C. § 1610(a)(1) (1982). *See* S. & S. Machinery Co. v. Masinexportimport, 706 F.2d 411, 416 (2d Cir. 1983); *Libra Bank*, 676 F.2d at 49-50.

[177]Nichols, *supra* note 59, at 258. Such clauses waive immunity as to all property rather than merely commercial property. *Id.*

and economic implications. Politically, the attachment of a sovereign debtor's assets may have an adverse effect on the United States' relations with that country. The potentially adverse effect could be increased if the executive branch had been active in negotiations with that country to resolve its difficulties in servicing its external debt obligations.

In relation to the American economy, the removal of substantial amounts of foreign central bank funds would have an immediate and adverse effect on both the United States balance of payments and the strength of the American dollar.[178] Further, the removal of foreign reserves invested in United States government securities could seriously affect the United States government's ability to manage the public debt.[179] If American courts were to allow such attachments, foreign central banks, including those not involved in litigation, might remove their assets to more secure jurisdictions.

A narrow interpretation by the courts of the statutory exceptions to immunity from attachment of foreign sovereign assets has been advocated to prevent disruptions in the international monetary system.[180] Some bankers feel it is unlikely a creditor would seek an attachment because pressure would be exerted by the banking community.[181] Nevertheless, a creditor armed with an agreement containing a waiver clause would be able to invoke the power of a court to prevent a defaulting sovereign from removing its assets.

VI. Looking to the Future

Although the severity of the foreign sovereign debt crisis has subsided somewhat since 1982,[182] the spectre of large-scale defaults continues to loom on the horizon. A look at the primary actors facing the problem will raise the issues they must confront in seeking a long-term resolution of the crisis. In the final analysis, the courts are not now the proper forum in which to resolve this complex problem which could have devastating consequences for the American banking system as well as the international monetary system.

A. The Banks

American commercial banks have not sought judicial resolution of

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[178]Patrikis, *Foreign Central Bank Property: Immunity from Attachment in the United States*, 1982 U. Ill. L. Rev. 265, 266 (1982).

[179]*Id.* "At year end 1981, foreign official institutions held about $169.6 trillion in U.S. bank liabilities, U.S. government obligations, and U.S. corporate stock and bonds." *Id.* (citing 68 Fed. Reserve Bull. A58 (1982)).

[180]Patrikis, *supra* note 178, at 287. *See* 28 U.S.C. § 1611(b)(1) (1982).

[181]Kristof, *supra* note 20, at 38, col. 2.

[182]*See supra* note 5-6.

the sovereign debt problem to any great extent.[183] This is due to a number of factors, including the extreme difficulty of executing on a judgment, the extent of banks' exposure in the international markets,[184] banks' desire to transact future business with presently troubled debtors, and the desire for a continued perception by foreign investors that the United States is a "safe" jurisdiction in which to invest central bank funds.[185]

These factors are in part responsible for the reluctance of banks to seek judicial enforcement of non-performing loans. Banks have preferred to renegotiate existing loan obligations, and in some instances extend additional credit, on an *ad hoc* basis. Their preference for renegotiation is reinforced by the willingness of sovereign debtors to enter into such talks.

Willingness on the part of sovereign borrowers to come to the bargaining table rather than repudiate their debts is a reflection of recent changes in the global economic and political order.[186] These changes include the growing interdependence of nations, the existence of supranational banking institutions such as the International Monetary Fund (IMF) and the World Bank, the high level of intergovernmental debt, and the fact that the creditors are now predominantly commercial banks that can cut off even short-term trade financing.[187] The factors compelling bargaining are economic and political rather than legal.

One commentator has suggested that sovereign borrowers' debt servicing difficulties, at least in the intergovernmental context, should be viewed as development problems rather than as collection problems.[188] Sustained economic growth by the lesser developed countries is unquestionably in the best interests of the American commercial banks. Yet while this perception of the debt servicing problem is a reflection of the interdependence nature of the global economic order, their own viability presumably remains the paramount interest of the affected American banks.

The banks have taken the steps necessary to invoke the jurisdiction of American courts for enforcement of sovereign loan agreements.[189] The result of the *Allied Bank*[190] litigation suggests this to be a viable

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[183]Reisner, *supra* note 1, at 6.

[184]*See supra* note 4. Because it is difficult for the major creditors to reduce their exposure in Latin America, they will most likely stretch their loan commitments at least into the remainder of this century. Comment, *International Debt*, *supra* note 2, at 856-57 n.15.

[185]*See supra* notes 178-79 and accompanying text.

[186]Clarke & Farrar, *supra* note 18, at 262-63.

[187]*Id.*

[188]Comment, *International Debt*, *supra* note 2, at 884-85.

[189]*See supra* note 7 and accompanying text.

[190]757 F.2d 516.

alternative. Such a victory may, however, be a hollow one, given the difficulty in executing on a judgment and the likelihood of balance sheet reductions in the wake of the declared default.

The prospect of further litigation depends on the desire of the banks to initiate such action. Pressures brought to bear from within the banking community on smaller creditors, at comparatively less risk in declaring a default, lessen the likelihood of an increase in litigation. The major creditors, with a greater stake in the outcome of the sovereign debt crisis, have thus far opted for renegotiation of the loan obligations. The possibility of future litigation depends on the banks, who may well continue to pursue other nonlitigious alternatives.[191]

B. The Executive Branch

The executive branch must consider a number of variables in its policy formulation in response to the problem of foreign sovereign debt owed to American commercial banks. Domestically, it must be concerned with the solvency of the banks, which would be jeopardized in the event of a large-scale default. The banks presently comprise a system "over-extended" and "fragile."[192]

Some experts contend that the Federal Reserve could assist the banks in adjusting to a debt moratorium.[193] That contention is speculative, given the percentage of bank capital represented by loans to foreign sovereigns.[194] Capital losses would significantly reduce both bank earnings and shareholders' equity and most likely would result in a contraction of available domestic credit. It has also been suggested that the Federal Reserve Board could alleviate the squeeze on banks forced to write off loans by liberalizing its reserve requirements.[195]

Also of domestic economic importance is the United States' trade balance. In order to meet debt repayment schedules, many lesser developed countries have significantly reduced purchases of imports from the industrialized countries, including the United States.[196] In 1982 Amer-

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[191]Recently, Citicorp secured $900 million worth of insurance against losses on loans to four Latin American nations and the Philippines. According to a 10-Q form filed with the Securities and Exchange Commission, the insurance, believed to be the first acquired by an American banking organization, " 'protects against the risk of major losses from prolonged delays in receiving funds from a country because of a government's inability or refusal to make the foreign exchange (payment) available.' " The Indianapolis Star, Sept. 8, 1984, at 33, col. 1.

[192]Silk, *supra* note 29, at 30.

[193]*How an LDC Default Would Hit the U.S. Economy*, BUSINESS WEEK, Nov. 7, 1983, at 118 [hereinafter cited as *LDC Default*].

[194]*See supra* note 4.

[195]*LDC Default, supra* note 193, at 118.

[196] H.R. REP. No. 98-175, 98th Cong., 1 Sess. 3, *reprinted in* 1983 U.S. CODE CONG. & AD. NEWS 1898, 1959.

ican exports to the six largest developing countries fell by thirty percent.[197] Relieving the debt servicing burden on these countries is crucial to their economic development, which in turn is necessary to stimulate the purchase of American exports.

Internationally, the executive branch must maintain relations with countries beset by slumping economies and debt servicing burdens. Declarations of default by American banks could have a direct impact on those relations. Breakdown of political alliances as well as trade relationships may occur. The austerity programs urged by creditors could result in political upheavals, particularly in those countries with fragile democratic systems.

The executive branch must also confront the proposal endorsed by a number of lesser developed countries for a new international economic order. The global approach to the sovereign debt problem favored by some developing countries involves the creation of new international institutions and a large discounting of the debt.[198] The costs of discounting of the debt would be absorbed by the banks and taxpayers of the United States and the other creditor nations.[199]

Generally, the executive branch has taken the position that "[a]ny lasting solution to the debt crisis must center around the commercial banks."[200] It has advocated that the banks roll over existing debt and in some cases increase lending.[201] The executive branch has participated, along with the International Monetary Fund and the other creditor nations, in the *ad hoc*, case-by-case approach utilized thus far in attempting to resolve the debt crisis. Beyond urging debtor nations to provide incentive and commercial opportunities to private enterprise,[202] there has been no apparent comprehensive approach enunciated by the executive branch to effect a long-term resolution of the crisis.

In the event of a large-scale default, some commentators have proposed that direct action could be taken by the executive branch.[203] They suggest that the executive could freeze the defaulting nation's assets located in the United States and set up a claims settlement at a national level.[204] While this approach might avoid the problem of depletion of the debtor's assets caused by numerous attachments in individual lawsuits,

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[197]*Id.* A decline in export sales results in the loss of billions of dollars of income and has a negative impact on unemployment rates. *Id.*

[198]Farnsworth, *I.M.F. Chief Sees Third-World Gain*, N.Y. Times, Sept. 28, 1984, at 35, col. 4.

[199]*Id.*

[200]Wallis, *supra* note 34, at 42.

[201]*Id.* at 43.

[202]*Id.*

[203]Barnett, Galvis & Gouraige, *supra* note 2, at 124.

[204]*Id.*

as the President could nullify those attachments,[205] there would be political and economic repercussions if such action were taken.[206]

The executive branch's case-by-case approach has its merits, the foremost being flexibility in dealing with the particular circumstances involved. By virtue of its position taken in the appeal of *Allied Bank*[207] that unilateral alterations of debt obligations are inconsistent with American policy,[208] the executive branch has apparently given a signal to the courts that it approves of legal enforcement of sovereign loan agreements.

However, the numerous and complex issues presented in sovereign default cases cannot be effectively resolved in the courts. The interests involved in these cases are domestic, including the stability of the banking system and the rising budget and trade deficits, as well as international. The executive branch, with the power to effect a resolution encompassing all of the interests at stake, should take the lead in addressing this crisis with its potentially devastating consequences.

C. Congress

Congress, in codifying the jurisdictional question of sovereign immunity, did not address the act of state doctrine.[209] While recognizing that foreign sovereigns involved in commercial activities cannot evade the jurisdiction of American courts by claiming sovereign immunity, the legislative branch has left the courts to grapple with the question of whether to address the merits of such cases. A clear legislative mandate on the issue of liability in sovereign debt disputes is one alternative to case-by-case determinations.

The Supreme Court in *Sabbatino* determined that the act of state doctrine precluded a challenge to the validity of the Cuban expropriation.[210] In reaction to that decision, Congress passed the Hickenlooper Amendment[211] to the Foreign Assistance Act of 1961. The amendment directs that cases arising out of foreign expropriations be decided on the merits unless the executive branch intervenes.[212]

This statutory exception to the act of state doctrine has subsequently been construed to apply only to claims of title or other rights to specific

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[205] *Id.* A default could be deemed a crisis under the International Economic Powers Act, giving the executive the power to nullify any attachments. *See* 50 U.S.C. § 1702(a)(1) (1982); *see also* Dames & Moore v. Regan, 453 U.S. 654 (1981).

[206] *See supra* notes 178-79 and accompanying text.

[207] 757 F.2d 516.

[208] *Id.* at 519-20.

[209] *See supra* note 62 and accompanying text.

[210] 376 U.S. at 438.

[211] 22 U.S.C. § 2370(e)(2) (1982).

[212] *Id.*

property expropriated abroad.[213] It represents, nonetheless, an attempt by the legislative branch to address the question of whether American interests harmed by the acts of a foreign sovereign can gain redress in American courts. No analogous action has been taken in response to the current debt crisis to direct the courts on the question of liability for sovereign defaults.

The legislative branch has, however, taken steps to address the debt crisis. In 1983 Congress enacted the International Lending Supervision Act.[214] The Act, among other provisions, calls for implementation of strengthened domestic and international bank supervisory practices, disclosure by banks of their foreign sovereign debt exposure, and establishment in some instances of special reserves on international loans.[215]

The legislative history of the Act reveals a recognition by Congress of the problems faced by the developing nations and a desire to work in cooperation with those countries to devise a long-range solution to the debt crisis.[216] Further legislation could call for the creation of new international institutions responsible for monitoring the stability of the international monetary system. Congress has recognized the need for comprehensive solutions, which cannot be achieved through piecemeal adjudications.

D. The Courts

In a default case brought by an American creditor against a foreign sovereign debtor the threshold question of sovereign immunity has been simplified by the enactment of the FSIA. The courts are still faced, however, with the task of resolving the question of whether to address the merits of the case. The decision of whether to invoke the act of state doctrine involves analyzing the issue of deference to the foreign affairs competence of political branches.

The Second Circuit in *Allied Bank* found the act of state doctrine inapplicable because there was no taking of property by Costa Rica within its own territory.[217] The territorial limitation on the preclusive scope of the act of state doctrine is premised on the notion that the situs of the debt is controlling.[218] If the taking of a right to repayment cannot be effected within the territory of the sovereign debtor, the act of state doctrine is inapplicable.

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[213] *See, e.g.*, Menendez v. Saks, 485 F.2d 1355 (2d Cir. 1973), *cert. denied*, 425 U.S. 991 (1976); French v. Banco Nacional de Cuba, 23 N.Y.2d 46, 242 N.E.2d 704, 295 N.Y.S.2d 433 (1968).

[214] 12 U.S.C.A. §§ 3901-12 (West Supp. 1985).

[215] *Id.*

[216] H.R. REP. No. 98-175, 98th Cong., 1 Sess. 3, *reprinted in* 1983 U.S. CODE CONG. & AD. NEWS 1898, 1904.

[217] 757 F.2d at 522.

[218] *Id.* at 521.

The act of state doctrine, after *Sabbatino*, involves institutional concerns in making decisions in the area of international relations.[219] Inherent in the territorial limitation is the notion that the judgment of the judicial branch will not vex United States relations with foreign nations if the foreign state does not have an expectation of dominion over the property in question.[220] Limiting analysis of the act of state doctrine to the question of dominion leads to the possibility of offense to the sovereignty of the foreign state and conflict with policy initiatives of the political branches of government.

While the act of state doctrine is not mandated by the text of the Constitution, it does have "constitutional underpinnings."[221]

> It arises out of the basic relationships between branches of government in a system of separation of powers. It concerns the competency of dissimilar institutions to make and implement particular kinds of decisions in the area of international relations. The doctrine as formulated in past decisions expresses the strong sense of the Judicial Branch that its engagement in the task of passing on the validity of foreign acts of state may hinder rather than further this country's pursuit of goals both for itself and for the community of nations as a whole in the international sphere.[222]

The courts are faced with the task of balancing the vital national interests of both the United States and debtor sovereigns. In the context of the foreign debt crisis, the competency of the courts to balance these interests successfully is questionable. As stated by the court in *In re Uranium Antitrust Litigation*,[223] "[T]he judiciary has little expertise, or perhaps even authority, to evaluate the economic and social policies of a foreign country."[224]

Another consideration in the foreign debt crisis is a sensitivity to, as described by the *Sabbatino* Court, the "practical and ideological goals of the various members of the community of nations."[225] The "basic divergence between the national interests of the capital importing and capital exporting nations"[226] is of major concern in the resolution of

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[219]376 U.S. at 423.

[220]*Libra Bank*, 570 F. Supp. at 883. "The underlying notion embodied in the territorial limitation is the considered judgment of the judicial branch that courts will vex our relations with foreign governments only when they act to frustrate the foreign nation's reasonable expectations of dominion." *Id.* at 884.

[221]376 U.S. at 423.

[222]*Id.*

[223]480 F. Supp. 1138 (N.D. Ill. 1979).

[224]*Id.* at 1148.

[225]376 U.S. at 430.

[226]*Id.* As suggested by the Court, "no area touches more sensitively on the practical and ideological goals of states." *Id.*

the foreign debt crisis. The debtor countries are advocating a broader agenda in resolution of the crisis, calling for a "new equilibrium" that would give the capital importing countries greater input in world economic policies, including adjustments in international interest rates.

It has been proposed that the federal courts should adopt a presumption of abstention from examining a foreign government's acts and look to the political branches for guidance.[227] In general, given the current trend of increasing governmental participation in the international marketplace, that proposal is an overstatement. As stated by Justice Powell in *First National City Bank v. Banco Nacional de Cuba*,[228] the courts should not abdicate their responsibility to address issues arising from transactions involving foreign sovereigns.[229] Because "the courts of the various countries afford the best means for the development of a respected body of international law," there is less hope for such development if all acts of state are relegated to the political branches.[230]

Perception of a more active role for the courts is shared by those who, contrary to the suggestion that the courts adopt a presumption of nonjusticiability, view American courts as "agents of development" of the international legal order.[231] According to this view, the domestic courts have a responsibility to improve the quality of international legal stability and help to overcome institutional deficiencies on a supranational level.[232] The courts should be devoted to the task of reducing international tensions by carrying out judicial duties without assuming a partisan posture.[233]

This position was addressed by the Supreme Court in *Sabbatino*. The Court stated that the contention presumes decisions of the United States courts "would be accepted as disinterested expressions of sound legal principle."[234] Such acceptance is unlikely in the context of the debt crisis, given the delicate foreign relations aspects. Judgments by American courts in favor of American creditors could intensify conflict between the creditor and debtor nations.

The factors to be addressed by the court in a default action are complex and far-reaching. It is questionable whether the courts are able

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[227]Note, *Judicial Balancing*, *supra* note 85, at 352.

[228]406 U.S. 759.

[229]*Id.* at 775 (Powell, J., concurring).

[230]*Id.*

[231]*See, e.g.*, Falk, *Toward a Theory of the Participation of Domestic Courts in the International Legal Order: A Critique of* Banco Nacional de Cuba v. Sabbatino, 16 RUTGERS L. REV. 1, 2 (1961).

[232]*Id.*

[233]*Id.* at 41.

[234]376 U.S. at 434-35. Some commentators have questioned whether American courts can behave disinterestedly when applying domestic law to international questions. *See, e.g.*, Kleinman, *supra* note 80, at 132.

to balance adequately all the interests involved. Judicial balancing is made more difficult by the lack of a contemporary Supreme Court declaration on the act of state doctrine, which might better define the notion of institutional relationships inherent in the doctrine.

VII. Conclusion

The historically unprecedented lending by American commercial banks to foreign sovereigns has resulted in a crisis prècipitated by the inability of the debtor nations to service adequately their loan obligations. Debt rescheduling has alleviated the crisis in the short term. Participating American banks have sought legal remedies to a minimal extent. It remains uncertain to what extent they will do so in the future.

The terms of the loan agreements give American courts subject matter jurisdiction over default actions. The courts are then faced with the question of justiciability, which requires a balancing of national interests and international relationships. Determination of the justiciability issue involves the competency of the courts to balance these interests effectively. *Allied Bank* indicates that sovereign debt questions are in fact justiciable, making judicial deference to the political branches unnecessary.

Long-term resolution of the crisis will be achieved through political processes, not by piecemeal adjudications. Recognition of the political and economic interdependence of the members of the international community should lead to multilateral agreements and the creation of new international institutions. Establishment of supranational institutions will involve the difficult task of overcoming perceived threats to national sovereignty. National financial and economic policies are an integral part of the exercise of that sovereignty, making the difficult task of reaching a compromise resolution of the debt crisis a function of political rather than legal processes.

Gary W. Larson

Citizen Standing in Environmental Licensing Procedures: Not In *My* Neighborhood!

I. Introduction

In today's highly industrialized, waste producing society, the efficient, safe treatment and disposal of wastes is critical to the public health and to environmental integrity. Modern publications are replete with accounts of the disastrous consequences of unsound waste treatment and disposal practices.[1]

Legislatures have created administrative agencies to administer the extensive, complex laws that govern treatment and disposal of the various kinds of waste. The United States Environmental Protection Agency is the primary federal agency.[2] In Indiana, these agencies include the Environmental Management Board,[3] Air Pollution[4] and Stream Pollution

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[1]*See, e.g.*, S. Epstein, M.D., L. Brown, & C. Pope, Hazardous Waste in America (1982). This book describes many of America's waste disposal mistakes, including the infamous Love Canal disaster which occurred in Niagara Falls, New York. *Id.* at 90-132. Indiana has not escaped the effects of unsound waste management. For example, several sites in Monroe County, Indiana, are extensively contaminated with polychlorinated biphenyls (PCBs), which are toxic chemicals and suspected carcinogens. *See* Bloomington Herald-Telephone, Dec. 6, 1984, at 1, col. 1. These chemicals were used by the Westinghouse Corporation to manufacture electrical capacitors at its Bloomington, Indiana plant from 1958 until the 1970's. *Id.*

[2]The EPA was created under a presidential reorganization plan that transferred to the new agency certain functions previously performed by the Secretary of Interior, Department of Interior, Secretary of Health Education and Welfare, and Department of Health Education and Welfare. Reorg. Plan. No. 3 of 1970, 35 Fed. Reg. 15,623 (1970), *reprinted in* 5 U.S.C. app. 1132 (1982), *and in* 84 Stat. 2086 (1970).

[3]The Environmental Management Board was created under Ind. Code § 13-7-2-1 (1982) (repealed effective July 1, 1986). The Board's duties include: (1) evolving and keeping updated a long-term plan for protection of the environment; (2) developing and promulgating regulations to protect the environment; (3) procuring compliance with the regulations; (4) surveying and inspecting solid waste management sites, public water supplies, and actual or threatened sources of environmental pollution; and (5) encouraging and assisting local governments in developing programs and facilities for pollution control. Ind. Code § 13-7-3-1 (1982) (repealed effective July 1, 1986). Regulations promulgated by the Board include the Hazardous Waste Management Program, 320 Ind. Admin. Code 4.1-1-1 to 4.1-56-3, promulgated at 8 Ind. Reg. 1721 (1985), and the Solid Waste Management Program, 330 Ind. Admin. Code 4-1-1 to 4-9-5 (1984). The Environmental Management Board will hereinafter be referred to as the "EMB."

[4]The Air Pollution Control Board was created under Ind. Code § 13-1-1-3 (Supp. 1985). The Board's powers and duties include: (1) adopting and promulgating reasonable rules to maintain air quality; (2) making investigations, considering complaints, and holding hearings; and (3) entering orders or determinations to protect the air quality. Ind. Code § 13-1-1-4 (Supp. 1985). The Board has promulgated extensive regulations pursuant to its powers. *See* 325 Ind. Admin. Code 1.1-1-1 to 14-6-1 (1984 & Supp. 1985).

Control Boards,[5] the Department of Natural Resources,[6] the Natural Resources Commission,[7] and the Solid Waste Facility Site Approval Authority.[8] Collectively, these agencies are responsible for licensing the operations that may seriously harm the public health and the environment. Many of these operations involve generation, treatment, storage, or disposal of wastes and include sanitary landfills,[9] hazardous waste management facilities,[10] domestic and industrial wastewater treatment

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[5]The Stream Pollution Control Board is the oldest of the environmental agencies, having been established in 1943. IND. CODE § 13-1-3-1 (Supp. 1985). The Board has the power to bring any action in law or equity necessary to protect the waters of the state. IND. CODE § 13-1-3-5 (Supp. 1985). The Board also has the power to make regulations and issue orders restricting the pollution content of any material discharged into the waters of the state. IND. CODE § 13-1-3-7 (Supp. 1985). Regulations promulgated by the Board include the Wastewater Treatment Facility Permit Program. 330 IND. ADMIN. CODE 3.1-1-1 to 3.2-1-13 (1984).

The 1985 Indiana General Assembly enacted legislation that creates an environmental super-agency, the Department of Environmental Management, and redefines the duties of the Air and Stream Pollution Control Boards, and the Environmental Management Board. Pub. L. No. 143-1985. This new legislation will be discussed *infra* at text accompanying notes 194-236.

[6]The Department of Natural Resources is charged with enforcement of state laws relating to fisheries, forests, and game. IND. CODE § 14-3-1-1 (1982). The Department has the power to: (1) regulate forestry, IND. CODE § 14-3-1-13 (1982); (2) regulate conduct in state parks and forests, IND. CODE § 14-3-1-14 (Supp. 1985); (3) prevent pollution of lakes, *id.*; (4) regulate fishing and hunting; *id.*; and (5) regulate drainage and reclamation of lands, IND. CODE § 14-3-1-15 (1982).

[7]The Natural Resources Commission exists pursuant to IND. CODE § 14-3-3-3 (Supp. 1985). The Commission's primary responsibility is natural resource conservation, such as water, land, oil, gas, forest, and wildlife conservation. IND. CODE § 14-3-3-8 (1982).

[8]The Solid Waste Facility Site Approval Authority was created in 1981 pursuant to IND. CODE § 13-7-8.6-3 (1982). This agency will soon be called the Hazardous Waste Facility Site Approval Authority. IND. CODE § 13-7-8.6-3 (Supp. 1985) (effective July 1, 1986). The Authority's primary responsibility is to issue or deny a certificate of environmental compatibility to a hazardous waste facility that is to be located in the state. *See* IND. CODE § 13-7-8.6-5 (1982).

[9]A sanitary landfill is generally a level area of land that is excavated then filled with non-hazardous waste. The waste is spread thin, compacted, and covered with soil at the end of each day. The wastes disposed of at these facilities generally constitute domestic garbage.

[10]Management of hazardous wastes includes their treatment, storage, and disposal. Hazardous wastes are those which are so defined by the United States Environmental Protection Agency. 40 C.F.R. §§ 261.1 to 261.33 (1984). Indiana has adopted the federal hazardous waste lists. 320 IND. ADMIN. CODE 4.1-3-1 to 4.1-6-4, promulgated at 8 Ind. Reg. 1728-57 (1985). Under Indiana law, hazardous wastes are also defined as those which, due to their quantity, concentration, or physical, chemical, or infectious characteristics, may: (1) cause or contribute to an increase in mortality or increase in serious illness; or (2) pose "a substantial present or potential hazard to human health or the environment when improperly treated, stored, transported, or disposed of, or otherwise managed." IND. CODE § 13-7-1-2(a)(17) (1982) (repealed and reenacted at IND. CODE § 13-17-1-12) (Supp. 1985) (effective July 1, 1986). The most common hazardous waste disposal facility is a landfill.

plants,[11] and industries which emit air contaminants.[12]

Because of the tremendous impact environmental licensing decisions may have on local communities and private citizens, these entities are questioning the soundness of the decisions made by the licensing agencies. Those who question the licensing decisions are essentially saying, "Yes, we recognize that these facilities are necessary, but they don't belong in *our* neighborhood." To add legal bite to their objections, communities and citizens must first clear a major hurdle, however, by establishing their standing to participate in, and seek judicial review of, an environmental agency's decision to issue a permit or license. In Indiana, the standing issue was recently resolved in favor of the citizen objector in *Indiana Environmental Management Board v. Town of Bremen*.[13]

In that case, the town of Bremen, Indiana, and various individual citizens sought to prevent the Environmental Management Board's issuance of a permit for the operation of a sanitary landfill near the town.[14] The plaintiffs claimed the aquifer below the proposed landfill would be contaminated, and other deleterious health and environmental effects would result from the operation of the landfill.[15] During a public hearing, the plaintiffs protested the permit's issuance, but to no avail. When the EMB issued the permit, the plaintiffs brought suit for judicial review of that administrative agency action. The *Town of Bremen* court held that the plaintiffs had standing to sue, and that their due process rights had been violated by the agency's failure to follow the proper procedure in issuing the permit.[16] The court failed, however, to state how and why the plaintiffs' asserted injuries satisfied state standing requirements.

This Note will present the state statutes relevant to resolution of the citizen standing issue addressed in *Town of Bremen*.[17] Four facets of *Town of Bremen* will then be discussed in detail: the decision itself, the permit issuance procedure it prescribes, the court's faulty rationale, and the decision's potentially adverse impact. The 1985 legislative response to *Town*

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[11]Generally, wastewater treatment plants remove contaminants from domestic and industrial wastewater and discharge the treated water into streams and rivers. Domestic wastewater is more commonly known as sewage. Industrial wastewater is generated, for example, in steel manufacturing and metal plating process.

[12]These types of industries include steel mills, oil refineries, copper smelters, automobile manufacturing plants, and power plants.

[13]458 N.E.2d 672 (Ind. Ct. App. 1984), *transfer denied*, May 3, 1984.

[14]*Id.* at 673.

[15]Brief for Appellee Dale Sherk at 26-27, Brief for Appellee Town of Bremen at 2-3, Indiana Envtl. Management Bd. v. Town of Bremen, 458 N.E.2d 672 (Ind. Ct. App. 1984).

[16]458 N.E.2d at 675.

[17]Cases and issues arising under the National Environmental Policy Act are not within the scope of this Note. 42 U.S.C. §§ 4321-4370a (1982). Indiana has specifically excluded the issuance of permits from its state environmental policy act's scope. *See* IND. CODE § 13-1-10-6 (1982).

of Bremen and the shortcomings of that legislation will next be examined. The conclusion of this Note will propose several remedies for the potentially adverse impact of both the *Town of Bremen* decision and the legislation recently enacted.

II. Judicial and Legislative Requirements for Standing

A. Preliminary Considerations

The standing requirements set forth by the United States Supreme Court and Indiana state courts are similar. Indiana's judicial standing requirements are applicable to state administrative proceedings.[18] A brief review of basic standing principles is essential for an understanding of this Note's analysis of *Town of Bremen*.

The Supreme Court's standing rules derive from its interpretation of the United States Constitution's "case" or "controversy" requirement and from the Court's prudential considerations.[19] In general, a plaintiff has standing to bring suit and challenge an administrative agency's action if he can show an injury in fact and can show that such injury affected an interest within the zone of interests protected by the statute the agency has allegedly violated.[20] "A plaintiff must allege that he has been or will in fact be perceptibly harmed by the challenged agency action, not that he can imagine circumstances in which he could be affected by the agency's action."[21] The "injury in fact" requirement is most pertinent to discussion of the *Town of Bremen* decision because the court overlooked this fundamental standing requirement. In other words, the court should have required that the *Town of Bremen* plaintiffs show that the licensing of the landfill by the EMB would in fact cause them harm.

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[18]Indiana Alcoholic Beverage Comm'n v. McShane, 170 Ind. App. 586, 596, 354 N.E.2d 259, 266 (1976).

[19]U.S. Const. art. III, § 2. *See, e.g.,* Valley Forge Christian College v. Americans United for Separation of Church and State, 454 U.S. 464 (1982). Indiana's constitution states that "[a]ll courts shall be open; and every man for injury done to him in his person, property, or reputation, shall have remedy by due course of law." Ind. Const. art. I, § 12. *See also* Donato v. Dutton, Kappes & Overman, 154 Ind. App. 17, 288 N.E.2d 795 (1972).

[20]Sierra Club v. Morton, 405 U.S. 727 (1972). Indiana's standing requirements are the same. *See, e.g.,* State *ex rel.* State Bd. of Tax Comm'rs v. Marion Superior Court, 271 Ind. 374, 392 N.E.2d 1161 (1979) (plaintiff must show a demonstrable injury); Terre Haute Gas Corp. v. Johnson, 221 Ind. 499, 45 N.E.2d 484 (1943) (plaintiff must show he has sustained or is in immediate danger of sustaining a direct injury); Cablevision of Chicago v. Colby Cable Corp., 417 N.E.2d 348 (Ind. Ct. App. 1981) (plaintiff must show his injury to a present interest is more than a remote possibility).

[21]United States v. Students Challenging Regulatory Agency Procedures (SCRAP), 412 U.S. 669, 688-89 (1973).

B. The Statutes

The *Town of Bremen* court based its decision on the Administrative Adjudication Act[22] and the Environmental Management Act.[23] Therefore, an in-depth discussion of that decision will require careful examination of the relevant provisions in these two acts.

1. *The Administrative Adjudication Act (AAA).*—The AAA sets forth the basic procedures to which virtually all state administrative agencies must adhere.[24] It is a complex statute that has grown increasingly difficult to apply because it has not been substantially revised since its enactment in 1947.[25]

The pertinent provisions for study of the *Town of Bremen* problem concern procedures for administrative agency decisionmaking and judicial review of administrative decisions made. The overall purpose of the AAA is:

> . . . to establish a uniform method of administrative adjudication by all agencies of the state of Indiana, to provide for due notice and an opportunity to be heard and present evidence before such agency and to establish a uniform method of court review of all such administrative adjudication.[26]

A license is "any agency permit, certificate, approval, registration, charter, membership, or other form of permission."[27] An administrative adjudica-

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[22]IND. CODE § 4-22-1-1 to -30 (1982 & Supp. 1985).

[23]IND. CODE § 13-7-1-1 to § 13-7-19-3 (1982 & Supp. 1985). The Environmental Management Act was substantially amended in 1985. *See* Pub. L. No. 143-1985, § 71-178 and 207, which sections become effective on July 1, 1986.

[24]Excluded agency actions are set forth in section two's definition of "administrative adjudication." IND. CODE § 4-22-1-2 (Supp. 1985). The Department of Revenue is entirely excluded under the definition of "agency." *Id.*

[25]1947 Ind. Acts 1451. The AAA was patterned after the Model State Administrative Procedure Act of 1944. MODEL STATE ADMINISTRATIVE PROCEDURE ACT, Commissioner's Prefatory Note, 14 U.L.A. 362 (1980). The framers of the model act have twice rewritten that Act entirely, having adopted a new model act in 1961, *id.* at 371, and again in 1981. *Id.* at 73 (Supp. 1985). The drafters of the newer model acts have opined that each major revision was necessary in view of the rapidly increasing involvement of administrative law in everyday modern life. MODEL STATE ADMINISTRATIVE PROCEDURE ACT, Commissioner's Prefatory Note, 14 U.L.A. 363 (1980) and 14 U.L.A. 75 (Supp. 1985). The Indiana legislature, nevertheless, has made no significant revision in the AAA since it was enacted almost forty years ago. This failure to update the AAA is one valid explanation for its undue complexity and ambiguity. The 1985 Indiana General Assembly did, however, create a commission whose purpose is to recodify and revise the AAA. Pub. L. No. 361-1985.

[26]IND. CODE § 4-22-1-1 (1982).

[27]IND. CODE § 4-22-1-2 (Supp. 1985). The terms "license" and "permit" will be used interchangeably in this Note.

tion is defined as "the administrative investigation, hearing, and determination of any agency of issues or cases applicable to particular persons."[28] If an agency's act meets this definition,[29] the AAA governs because section three states, "[i]n every administrative adjudication in which the rights, duties, obligations, privileges or other legal relations of any person are required or authorized by statute to be determined by any agency the same shall be made in accordance with this chapter and not otherwise."[30] The AAA applies to "all interested persons or parties" who desire an opportunity to settle or adjust "all claims, controversies and issues."[31] The AAA, however, "shall not apply to the proceedings for the issuance of licenses or permits on application, but the procedure for such license or permit . . . shall be under the provisions of the law relating to the particular agency."[32] Therefore, prior to the decision to issue a permit, the agency's enabling statute and regulations govern the permit application procedure and provide standards that must be met before the permit can be issued. Once the agency decides to issue a permit, however, the AAA fully applies to any further license-related proceedings.

The AAA has been described as a bifurcated statute, with sections three through thirteen covering proceedings before an agency, and sections fourteen through nineteen governing judicial review of an administrative decision.[33] Hence, while the issue or controversy is before the agency, the Act's first part governs the agency's proceedings.[34] Once the agency has rendered its decision, the Act's latter part governs court review of that decision.[35]

Due process and the AAA require that those persons affected by an agency's decision be given notice that a decision has been made.[36] The AAA is unclear as to how and when this notice must be given under various circumstances.[37] Under the version of section twelve that was in

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[28]IND. CODE § 4-22-1-2 (Supp. 1985). A "person" is defined as "any person, firm, association, partnership, or corporation. It shall also include municipalities and all political subdivisions of government against which any agency may make an order or determination." *Id.*

[29]The definition of administrative adjudication does, however, exclude several specific actions taken by particular agencies. *See* IND. CODE § 4-22-1-2 (Supp. 1985).

[30]IND. CODE § 4-22-1-3 (Supp. 1985).

[31]IND. CODE § 4-22-1-4 (1982).

[32]IND. CODE § 4-22-1-24 (Supp. 1985).

[33]Warram v. Stanton, 415 N.E.2d 114 (Ind. Ct. App. 1981); Zehner v. Indiana State Alcoholic Beverage Comm'n, 173 Ind. App. 600, 364 N.E.2d 1037 (1977).

[34]*Warram*, 415 N.E.2d at 116; *Zehner*, 173 Ind. App. at 604, 364 N.E.2d at 1039-40.

[35]*Warram*, 415 N.E.2d at 116; *Zehner*, 173 Ind. App. at 604, 364 N.E.2d at 1039-40.

[36]U.S. CONST. amend. XIV, § 1; IND. CODE § 4-22-1-1 (1982) (one purpose of the AAA is to provide for due notice and an opportunity to be heard); IND. CODE § 4-22-1-12 (1982) (notice of all final orders and determinations shall be given promptly to all parties) (this section was recently amended; *see infra* note 38); IND. CODE § 4-22-1-25 (Supp. 1985) (notice shall be provided to all persons affected by an agency's initial determination).

[37]*See infra* text accompanying notes 186-87.

effect when *Town of Bremen* was decided, "[n]otice of all final orders and determinations shall be given promptly to all parties to the hearing by the agency."[38] Section fourteen further provides that the fifteen-day period during which judicial review may be initiated does not begin to run until notice of the decision or determination has been received.[39] While former section twelve and present section fourteen are not ambiguous as to final agency decisions, section twenty-five, a dispositive provision in *Town of Bremen*, applies to initial decisions and confuses the most diligent reader.

Section twenty-five provides:

> (a) In matters where no order or determination can be made requiring a person to do or refrain from doing an act including, but not in limitation thereof, the issuance of licenses, assessment or determination of taxes or other liability, or the determination of status, any agency may notify the person or persons who will be affected by any initial determination by such agency by registered letter, return receipt requested, or in person, that as a result of an investigation made by such agency a certain determination is recommended and on the expiration of a time fixed but not less than fifteen (15) days, such determination will be made unless objections are filed within said time. . . .[40]

This provision indicates that a licensing proceeding is not a matter in which an order or determination can be made requiring a person to do or refrain from doing an act. This section thus appears to be internally inconsistent because, when a license is required, one must refrain from doing the act governed by the license unless a valid license has been issued. In a licensing proceeding, the agency must notify those who will be affected by its

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[38]IND. CODE § 4-22-1-12 (1982). This section was amended in 1984 and now no longer requires that notice of final orders and determinations be given. IND. CODE § 4-22-1-12 (Supp. 1985).

[39]IND. CODE § 4-22-1-14 (Supp. 1985). Thus, although IND. CODE § 4-22-1-12 no longer requires notice of final orders and determinations, section fourteen implicitly requires that such notice be given. Otherwise, the fifteen-day time period during which a petition for judicial review may be filed would never commence.

[40]IND. CODE § 4-22-1-25 (Supp. 1985). This section continues:

> In the event no objections are so filed, or in the event that objections are specifically waived in writing, the agency may enter the recommended determination without further notice and without hearing.
>
> (b) If objections are filed, full opportunity shall be afforded for the adjustment or settlement of such matter, controversy, or issue, and if such settlement or adjustment is made, the same shall stand as the determination without further notice or hearing. In the event no adjustment or settlement is so arrived at, then proceedings and hearings shall be had as provided in this chapter.

Id.

initial decision.[41] The affected persons may then object and may eventually obtain judicial review of the initial agency decision.[42]

Section fourteen of the AAA states the basic standing requirements to bring an action for judicial review of an agency's decision. It provides that "[a]ny party or person aggrieved by an order or determination made by any such agency shall be entitled to judicial review thereof in accordance with the provisions of this chapter. . . ."[43] Therefore, the standing test to bring an action for judicial review turns on the definition of a "person aggrieved" by an agency decision. Because Indiana judicial standing requirements apply in administrative proceedings,[44] an "aggrieved person" is necessarily a person who has suffered or will suffer an actual injury as a result of the agency's action.[45]

Section eighteen instructs the reviewing court that it shall not set aside the agency's decision unless the decision is:

> (1) arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law;
> (2) contrary to constitutional right, power, privilege or immunity;
> (3) in excess of statutory jurisdiction, authority, or limitations, or short of statutory right;
> (4) without observance of procedure required by law; or
> (5) unsupported by substantial evidence.[46]

In reviewing the agency's decision, the court may not determine the cause *de novo*, but shall only consider the record filed with the court.[47] This record consists of a "transcript of testimony adduced" at an administrative adjudicatory hearing, "exhibits admitted" at the hearing, and "all pleadings, exceptions, motions, requests and papers filed."[48]

The last AAA provision pertinent to discussion of *Town of Bremen* is the "conflict of laws" section.[49] When *Town of Bremen* was decided, this section provided that the AAA superseded or controlled any other law, whether enacted prior to or after enactment of the AAA.[50] Therefore, the AAA's requirements had to be read into any procedures set forth by an agency's enabling statute.

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[41]The term "may" in IND. CODE § 4-22-1-25 is mandatory, not permissive. Grether v. Indiana State Bd. of Dental Examiners, 239 Ind. 619, 623, 159 N.E.2d 131, 133 (1959).

[42]IND. CODE §§ 4-22-1-25, -14, and -30 (Supp. 1985).

[43]IND. CODE § 4-22-1-14 (Supp. 1985).

[44]*See supra* note 18 and accompanying text.

[45]*See supra* notes 20-21 and accompanying text.

[46]IND. CODE § 4-22-1-18 (Supp. 1985).

[47]*Id.*

[48]IND. CODE § 4-22-1-9 (1982).

[49]IND. CODE § 4-22-1-30 (Supp. 1985).

[50]IND. CODE § 4-22-1-30 (1982). Effective February 29, 1984, this section provides that the AAA's requirements prevail over any law "passed by the general assembly in 1947,

2. *The Environmental Management Act (EMA).*—The Indiana legislature enacted the EMA in 1972, thereby creating the Environmental Management Board, the state agency involved in *Town of Bremen.*[51] Chapter ten of the EMA prescribes procedures for licensing pollution control facilities.[52] One provision gives the public the opportunity to voice its concerns about the potential licensing of a hazardous waste or solid waste disposal facility.[53] More specifically, this section provides:

> (b) A public hearing shall be held on the question of the issuance of an original or renewal permit for a hazardous waste disposal facility under IC 13-7-8.5, or on the question of the issuance of an original permit for a solid waste disposal facility upon:
>
> (1) the request of the applicant;
> (2) the filing of a petition requesting a public hearing that is signed by one hundred (100) adult individuals who:
> (A) reside in the county where the proposed or existing facility is or is to be located; or
> (B) own real property within one (1) mile of the site of the proposed or existing facility; or
> (3) the motion of the [agency].
>
> The public hearing authorized by this subsection does not constitute an administrative adjudication under IC 4-22-1.[54]

This hearing, as expressly stated in the statute, is not the administrative adjudicatory hearing to which the AAA grants the right to judicial review.[55]

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regardless of whether such statute or statutes were passed before or after March 14, 1947." IND. CODE § 4-22-1-30 (Supp. 1985). The effect of this section is now unclear. The amendment appears to eliminate the AAA's super-act status regarding administrative procedures. Nevertheless, section three, to which the 1984 legislature made only a minor amendment, continues to provide that administrative adjudications shall be conducted in accordance with the AAA, "*and not otherwise.*" IND. CODE § 4-22-1-3 (Supp. 1985) (emphasis added).

[51]IND. CODE § 13-7-1-1 to § 13-7-19-3 (1982 & Supp. 1985) (substantially amended by Pub. L. No. 143-1985, effective July 1, 1986). Not only did the legislature create the EMB by passing the EMA but it made two pre-existing environmental agencies, the Stream and Air Pollution Control Boards, subservient in some respects to the new agency. The EMB became an environmental super-agency because it has the power to establish priorities and coordinate the functions and services of the Air and Stream Pollution Control Boards. IND. CODE § 13-7-2-9 (1982) (repealed effective July 1, 1986).

[52]IND. CODE § 13-7-10-1 to -5 (1982 & Supp. 1985). This chapter was substantially amended in 1985. See *infra* notes 196-208 and accompanying text for a discussion of these amendments.

[53]IND. CODE § 13-7-10-2 (Supp. 1985).

[54]*Id.*

[55]*Id.* At the public hearing, interested persons may informally comment on the question of permit issuance. The hearing is not an adversary proceeding. Generally, the testimony is not transcribed. See *infra* note 97 for a brief description of an adjudicatory hearing.

The public hearing is held on request, after the agency's staff has made its recommendation to the EMB that the permit should be issued.[56] After the public hearing, the EMB decides whether the permit should be issued. No EMA provision addresses the weight to be accorded the comments received at the public hearing, nor requires that the comments be considered at all.

Appeal from the agency's final decision to issue or deny a permit is governed by Indiana Code section 13-7-10-4, which states:

> (a) If a permit is denied or if the permit is issued with terms and conditions which are objectionable to the applicant, the applicant may petition for a hearing before the board or appropriate agency within fifteen (15) days after the date of receipt of the permit or notice of a denial of permit. Such a petition which is timely and which complies with any other requirements of the board or appropriate agency shall be granted. A person aggrieved by the denial of a petition for hearing or by the denial or issuance of a permit after hearing may seek judicial review thereof pursuant to IC 13-7-17. . . .[57]

This provision clearly grants a permit applicant the right to judicial review if his permit application is denied or if he is issued a permit with objectionable conditions.[58] The reference to code chapter 13-7-17, however, raises questions in interpreting the standing requirements of section 13-7-10-4.[59]

Section 13-7-17-1 states that "[a]ny person aggrieved by any final order or determination of the [sic] one (1) of the boards, may proceed under

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[56]IND. CODE § 13-7-10-2 (Supp. 1985).

[57]This section finishes:

> For the purposes of making such an appeal, the date of denial of the petition for hearing under this section is the date of the final determination of the board or agency.
>
> (b) At a hearing under this chapter, the petitioner has the burden of proving to the board or agency;
>
> (1) why the permit should be issued; or
>
> (2) why the terms and conditions of the permit are not justified or are otherwise invalid.
>
> (c) The board or appropriate agency may designate a person to be a hearing officer. Except as provided in this section, hearings will be conducted under IC 4-22-1.

IND. CODE § 13-7-10-4 (1982) (repealed effective July 1, 1986). This section is essentially replaced by IND. CODE § 13-7-10-2.5 (Supp. 1985) (effective July 1, 1986). The new section is extensively discussed at *infra* notes 197-236 and accompanying text.

[58]IND. CODE § 13-7-10-4 (1982) (repealed effective July 1, 1986).

[59]Indiana Envtl. Management Bd. v. Town of Bremen, 458 N.E.2d 672, 674-75 (Ind. Ct. App. 1984).

[the AAA] to obtain a judicial review."[60] Thus, the aggrievement standing requirement under the EMA is the same as that under section fourteen of the AAA; a person must be *aggrieved* by the agency action before he may bring suit for judicial review of that action.[61]

3. *The Citizen Suit Statute.*—The "citizen suit statute"[62] also addresses standing in the environmental context. Although the *Town of Bremen* court did not discuss this statute, the court did rely on a case which interpreted it.[63] This chapter, entitled "Standing to Sue," grants virtually everyone the right to bring suit "for the protection of the environment of the state from significant pollution, impairment or destruction."[64] No such action may be brought, however, unless certain procedural prerequisites are met.[65] The person intending to sue must first notify the appropriate agency of that intent.[66] The agency must then be given an opportunity to remedy the alleged problem because the statute states:

> No action shall be maintained under this chapter unless the administrative agency to whom such notice was given and having jurisdiction as set out in subsection (a) fails to investigate and conduct a hearing to determine whether or not the accused is a pollutor as defined by law or regulation. The complainant shall be joined as a party. If the agency fails to hold a hearing and make a final determination within one hundred eighty (180) days after receipt of notice by the Attorney General as provided in subsection (a), action may be maintained and such agency need not be joined as a party defendant.[67]

The citizen suit statute further provides that the agency must consider the pollution consequences in any administrative, licensing, or other procedure.[68] The agency may not authorize, approve, or permit continuance

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[60]IND. CODE § 13-7-17-1 (Supp. 1985). This section was amended in 1985, along with most of the environmental laws. *See* Pub. L. No. 143-1985 (effective July 1, 1986). Prior to July 1, 1986, IND. CODE 13-7-17-1 applies to the Air and Stream Pollution Control Boards and the Environmental Management Board. *See* IND. CODE §§ 13-7-17-1 and 13-7-1-2(2) (1982) (repealed effective July 1, 1986). After July 1, 1986, IND. CODE § 13-7-17-1 applies to the Air and Water Pollution Control Boards and the Solid Waste Management Board. *See* IND. CODE §§ 13-7-17-1 and 13-7-1-5 (Supp. 1985) (effective July 1, 1986).

[61]*Compare* IND. CODE § 13-7-17-1 (Supp. 1985) *with* IND. CODE § 4-22-1-14 (Supp. 1985).

[62]IND. CODE § 13-6-1-1 to -6 (1982 & Supp. 1985).

[63]State *ex rel.* Calumet Nat'l Bank v. McCord, 243 Ind. 626, 189 N.E.2d 583 (1963).

[64]IND. CODE § 13-6-1-1(a) (Supp. 1985).

[65]IND. CODE § 13-6-1-1 (Supp. 1985).

[66]IND. CODE § 13-6-1-1(a) (Supp. 1985).

[67]IND. CODE § 13-6-1-1(b) (Supp. 1985).

[68]IND. CODE § 13-6-1-1(e) (Supp. 1985).

of any conduct "which does" pollute, impair, or destroy the environment or is "reasonably likely to have such effect so long as there is a feasible and prudent alternative consistent with the reasonable requirements of the public health, safety and welfare."[69] Thus, no agency may grant a permit that will, or is reasonably likely to, pollute or impair the environment *unless* there is no feasible and prudent alternative.

III. The *Town of Bremen* Decision

A. The Facts and Procedural History

Indiana Waste Systems, Inc., the EMB's co-defendant, proposed to construct and operate a sanitary landfill,[70] Prairie View Landfill. The company submitted its application to the EMB for the construction and operation of this facility, as required by law.[71] Several adjoining and neighboring landowners, and the Town of Bremen (plaintiffs) vigorously opposed this proposed facility. To voice their concerns, the plaintiffs requested that a public hearing be held pursuant to Indiana Code section 13-7-10-2(b)(2).[72] The public hearing was held on June 23, 1981, at which plaintiffs contended, as throughout this litigation, that the landfill would damage the environment.[73] The citizens alleged that the landfill would cause serious and irreparable injury to their adjoining land, their environment, and their health.[74] The Town alleged that, because the landfill would be located atop the aquifer from which the entire Town draws its drinking water, it would almost certainly contaminate the aquifer and, consequently, their water supply.[75]

After the public hearing, the EMB voted to approve defendant Indiana Waste Systems' application and issue the permit.[76] From this administrative action, plaintiffs sought judicial review.

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[69]*Id.*

[70]*See supra* note 9.

[71]No person shall install, operate, conduct, or modify, without prior approval of the appropriate agency, any equipment or facility of any type which may cause or contribute to pollution or which may be designed to prevent pollution. Ind. Code § 13-7-4-1(6) (Supp. 1985). No person shall cause or allow the construction of sanitary landfill facilities without a valid construction plan permit. 330 Ind. Admin. Code 4-3-1 (1984). No person shall cause or allow the operation of a sanitary landfill without a valid operating permit. 330 Ind. Admin. Code 4-5-1 (1984).

[72]Brief for Appellant Indiana Waste Systems, Inc. at 3, Appeal from LaPorte Circuit Court, Indiana Envtl. Management Bd. v. Town of Bremen, 458 N.E.2d 672 (Ind. Ct. App. 1984).

[73]*Id.*

[74]Brief for Appellee Dale Sherk at 26-27, Indiana Envtl. Management Bd. v. Town of Bremen, 458 N.E.2d 672, 674.

[75]Brief for Appellee Town of Bremen at 2-3, Indiana Envtl. Management Bd. v. Town of Bremen, 458 N.E.2d 672, 674.

[76]Brief for Appellee Dale Sherk at 4, Indiana Envtl. Management Bd. v. Town of Bremen, 458 N.E.2d 672.

The Town of Bremen filed an action for judicial review in Marshall County,[77] while the citizen plaintiffs filed an identical action in Marion County.[78] The two causes were consolidated and venued to the LaPorte Circuit Court.[79] That court granted summary judgment for the plaintiffs and remanded the matter to the EMB.[80] The trial court found that the plaintiffs had standing as "aggrieved persons" under the AAA and the EMA to bring an action for judicial review, and that the EMB had failed to follow the proper procedure in issuing the permit to Indiana Waste Systems, Inc.[81] Specifically, the trial court found that the EMB had not erred by failing to provide plaintiffs with an opportunity for an adjudicatory hearing on the matter of the permit prior to its issuance. The court found that the EMB did err, however, in not providing the plaintiffs with an opportunity to settle or adjust their claims pursuant to code sections 4-22-1-4 and 4-22-1-25.[82] On remand, the EMB was instructed to provide plaintiffs the requisite opportunity for settlement and any other necessary proceedings, dependent upon the outcome of the settlement conference.[83] The trial court also vacated the EMB's decision to issue the permit and declared the permit void *ab initio*.[84] Both the EMB and Indiana Waste Systems, Inc. appealed the decision.

The plaintiffs in *Town of Bremen* then filed a mandamus action to compel the EMB to close the landfill, which had been in operation since the permit was issued.[85] This action was venued to the Johnson Circuit Court, which rendered judgment for the plaintiffs.[86] The EMB appealed the judgment in the mandamus action and this appeal was later consolidated with the appeal from the LaPorte Circuit Court decision.[87]

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[77]458 N.E.2d at 673.

[78]*Id.*

[79]*Id.*

[80]*Id.*

[81]Town of Bremen v. Indiana Envtl. Management Bd. and Indiana Waste Systems, Inc., Cause No. 44340-C (LaPorte Circuit Court April 22, 1983) (order denying defendants' motions to correct errors and remanding to EMB with amended findings of fact and memorandum decision).

[82]*Id.*

[83]The trial court further stated that "[a]s the EMB would appear to have already made its initial determination in this matter, the court would recommend that the plaintiffs be given fifteen (15) days from the date of receipt of this order in which to file their written objections to said initial determination and thereafter proceedings consistent with IC 4-22-1-25." Town of Bremen v. Indiana Envtl. Management Bd. and Indiana Waste Systems, Inc., Cause No. 44340-C (LaPorte Circuit Court January 14, 1983) (initial order granting summary judgment, findings of fact and conclusions of law, and memorandum decision, at 3 of memorandum).

[84](LaPorte Circuit Court April 22, 1983) (order entered upon consideration of motions to correct errors filed after prior order of January 14, 1983).

[85]458 N.E.2d at 673.

[86]*Id.* The EMB was later found in contempt for failure to close the landfill. *Id.*

[87]*Id.*

The Indiana Court of Appeals, Third District, identified the following issues as presented for its review:

> (1) whether the LaPorte Circuit Court erred in finding that the plaintiffs had standing to bring an action for judicial review;
> (2) whether the LaPorte Circuit Court erred in finding that the I.E.M.B. had denied the plaintiffs due process;
> (3) whether the LaPorte Circuit Court had jurisdiction to order the decision of the I.E.M.B. granting the permit as well as the permit itself to be set aside and vacated; and
> (4) whether the Johnson Circuit Court had jurisdiction to mandate the I.E.M.B. to terminate the operations of the landfill.[88]

The appellate court affirmed the LaPorte Circuit Court and reversed the Johnson Circuit Court.[89] The focus of this Note is the court's resolution of the first two issues. The remaining two issues will be discussed only when relevant to problems inherent in the permit issuance procedure prescribed by *Town of Bremen* and to potential problems created by the 1985 legislative response to *Town of Bremen*.

B. The Town of Bremen *Public Participation Scheme*[90]

The appellate court held that the Town of Bremen and the citizen plaintiffs had standing to bring an action for judicial review of the EMB's decision to issue a sanitary landfill permit to Indiana Waste Systems, Inc.[91] The court also imposed several procedural requirements[92] which, when followed to their logical end, allow citizen objectors to participate routinely in the environmental agencies' licensing decisions and later have a court review agency decisions to issue permits.

The *Town of Bremen* scheme clearly applies to sanitary landfill and hazardous waste disposal facility permits because an operative EMA provision applies to both types of facilities.[93] In addition, this scheme is applicable to other kinds of pollution control operations, such as air and water pollution control discharge permits.[94] The court's decision was based

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[88]*Id.* at 674.

[89]*Id.* at 677.

[90]The procedure that results from the *Town of Bremen* court's holding that citizen objectors have certain procedural rights in the permit issuance process will be referred to as the *Town of Bremen* public participation scheme, *Town of Bremen* procedure, or other similar variations.

[91]458 N.E.2d at 675.

[92]*Id.*

[93]IND. CODE § 13-7-10-2 (Supp. 1985).

[94]The Izaak Walton League of America did file a complaint for judicial review and injunction based, in part, on *Town of Bremen* and its resolution of the citizen standing issue. Indiana Division, Izaak Walton League of America, Inc. v. Indiana Air Pollution Control Bd. and General Motors Corp., No. S784 1596 (Marion County Superior Court

on statutes that apply to the Air and Stream Pollution Control Boards and the EMB.[95] For simplicity's sake, however, the scheme will only be presented as it relates to permits issued by the EMB.

Under the *Town of Bremen* scheme, the permit seeker first submits his application to the EMB's staff.[96] The staff reviews the application and makes a recommendation to the EMB that the permit either be issued or denied. If the staff recommends denial and the EMB concurs, the permit applicant may then request an adjudicatory hearing pursuant to Indiana Code section 13-7-10-4, potentially followed by judicial review of a hearing officer's adverse decision.[97]

If the agency staff recommends permit issuance, a public hearing may be requested pursuant to code section 13-7-10-2.[98] The EMB is not required to give public notice of the impending permit issuance.[99] The EMB

No. 7, filed December 17, 1984). The League alleged that the Air Pollution Control Board issued an air pollution discharge permit to General Motors for a truck assembly plant without giving fifteen days notice of the potential permit issuance, without awaiting written objections, and without providing the League an opportunity to settle. *Id.*

[95]The court relied on IND. CODE § 13-7-17-1 and the AAA in reaching its decision. *Town of Bremen*, 458 N.E.2d 672. INDIANA CODE § 13-7-17-1 then applied to the EMB or "an agency." IND. CODE § 13-7-17-1 (1982). An "agency" meant the Air or Stream Pollution Control Boards. IND. CODE § 13-7-1-2(a)(2) (1982) (repealed effective July 1, 1986). INDIANA CODE § 13-7-17-1 was amended by Pub. L. No. 143-1985, § 177 (effective July 1, 1986). This section continues to apply to the Air and Stream (renamed "Water") Pollution Control Boards and to the EMB (renamed "Solid Waste Management Board"). *See* Pub. L. No. 143-1985, § 73 (codified at IND. CODE § 13-7-1-5) (Supp. 1985) (effective July 1, 1986) and Pub. L. No. 143-1985, § 177 (amending IND. CODE § 13-7-17-1) (Supp. 1985) (effective July 1, 1986). The AAA applies to all state administrative agencies that are not specifically exempted from its coverage. See IND. CODE § 4-22-1-2 (Supp. 1985) and its definition of "agency."

[96]The application for a sanitary landfill construction permit must be submitted sixty days prior to the proposed date for start of construction. 330 IND. ADMIN. CODE 4-3-2 (1984). The EMB staff that evaluates the application is that of the Land Pollution Control Division of the Indiana State Board of Health.

[97]IND. CODE § 13-7-10-4 (1982) (repealed effective July 1, 1986). The hearing must be conducted pursuant to the AAA. *Id.* Such hearing would entail an informal adversary proceeding at which parties can present evidence and examine witnesses. IND. CODE § 4-22-1-8 (1982). Parties may be represented by counsel, IND. CODE § 4-22-1-22 (1982), and the testimony elicited at the hearing is transcribed to form a record of the proceeding. IND. CODE § 4-22-1-9 (1982). The hearing officer must determine all issues of fact on the record. IND. CODE § 4-22-1-10 (Supp. 1985).

[98]IND. CODE § 13-7-10-2 (Supp. 1985); *see supra* note 55. The public hearing is, however, required only on the question of issuance of an original or renewal permit for a hazardous waste facility or on the question of issuance of an original permit for a solid waste disposal facility. IND. CODE § 13-7-10-2(b) (Supp. 1985).

[99]When *Town of Bremen* was decided, no statutory or regulatory requirement to give such notice existed. Now, however, the state has very stringent, explicit public notice requirements regarding permits for certain hazardous waste management facilities. *See* 320 IND. ADMIN. CODE 4.1-39-6, promulgated at 8 Ind. Reg. 1905-06 (1985).

does, however, give such notice by publication in a local newspaper.[100]

At the public hearing concerned citizens may express their objections to the permit's potential issuance.[101] The EMB then initially decides whether to issue the permit. Up to this point, the EMB's actions are governed by the EMA and the agency's regulations.[102] Once the EMB makes its initial decision, the requirements of the AAA govern any further proceedings.[103] If the EMB's initial decision favors issuance, code section 4-22-1-25, as interpreted in *Town of Bremen*, requires that everyone who may be affected by the permit issuance be notified by registered mail of that decision.[104] In a *Town of Bremen* situation, all adjoining and neighboring landowners, and everyone who draws water from the aquifer below the proposed landfill, must apparently receive notice by registered mail.[105]

If no objections are filed within fifteen days of receipt of notice, the permit is issued and the procedure ends.[106] If objections are filed, the EMB must provide the objectors an opportunity for settlement or adjustment of the controversy.[107] The procedure ends if the controversy is resolved at the settlement conference, unless the settlement requires denial of the permit. In that case, the applicant may request an adjudicatory hearing and follow through to judicial review.[108]

If the controversy is not settled at the conference, the objectors can obtain an administrative adjudicatory hearing.[109] The *Town of Bremen* court did not state that this hearing is available to the objectors. The last sentence of the applicable code section clearly states, however, that "[i]n the event no adjustment or settlement is so arrived at, then pro-

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[100]Telephone interview with Guinn P. Doyle, Hazardous Waste Branch Chief, Division of Land Pollution Control, State Board of Health (October 26, 1984). Public notice of the potential permit issuance is considered an implicit requirement of IND. CODE § 13-7-10-2(b). *Id.* Failure to give notice would contravene the apparent legislative intent that the public be given an opportunity to be heard; if the public was unaware that a permit's issuance was being considered, it could not request the public hearing. *Id.*

[101]IND. CODE § 13-7-10-2(b) mandates that the hearing be held when requested by the appropriate entity.

[102]*See supra* text accompanying notes 32-35.

[103]*Id.*; Indiana Envtl. Management Bd. v. Town of Bremen, 458 N.E.2d at 675.

[104]458 N.E.2d at 675.

[105]See *Town of Bremen*, 458 N.E.2d at 674, where the court stated, "The individual plaintiffs allege that they are adjoining landowners to the landfill and the Town of Bremen alleges that the landfill is located over and upon the main aquifer which supplies all water to the town." This is the court's sole statement which hints at the reason the plaintiffs were "affected" by the EMB's permit issuance decision. The permit applicant is also an affected person under IND. CODE § 4-22-1-25 (Supp. 1985).

[106]IND. CODE § 4-22-1-25 (Supp. 1985).

[107]458 N.E.2d at 675; IND. CODE § 4-22-1-25 (Supp. 1985).

[108]IND. CODE § 13-7-10-4 (1982) (repealed effective July 1, 1986).

[109]IND. CODE § 4-22-1-25 (Supp. 1985); *Town of Bremen,* 458 N.E.2d at 675.

ceedings and *hearings* shall be had as provided in [the AAA]."[110] Judicial review is available if the hearing results in a decision adverse to the objectors' interests.[111] It is uncertain whether a permit will have been issued at this point. A permit may not be issued until a trial court affirms the agency's decision and all appeals are exhausted.[112]

Included at the end of this Note is Chart One, which more explicitly maps out the procedures required in the licensing of one facility. Contingencies not discussed in *Town of Bremen* are noted on the chart to show the complexity of the entire scheme.

C. *The Court's Erroneous Rationale*

The *Town of Bremen* decision was based on judicial precedent and statutes. The decisions on which the court relied, however, were not relevant to the *Town of Bremen* facts and the court's interpretation of the statutes was faulty.

The *Town of Bremen* court found *Sekerez v. Youngstown Sheet and Tube Co.* controlling.[113] In *Sekerez*, the plaintiff initiated an action under the environmental citizen suit statute[114] against a steel manufacturing company alleged to be in violation of state air pollution control standards.[115] Under that statute, before the citizen plaintiff can seek redress in court, he must first allow the agency one hundred eighty days to take remedial action.[116] The Air Pollution Control Board[117] conducted an investigation and issued an administrative order requiring the steel company to comply with the appropriate air pollution standards.[118] Sekerez then pursued his citizen suit in court.[119] The *Sekerez* court held that the plaintiff, who was apparently unsatisfied with the Board's action, should have first sought

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[110]IND. CODE § 4-22-1-25 (Supp. 1985) (emphasis added).

[111]IND. CODE § 4-22-1-14 (Supp. 1985); *Town of Bremen*, 458 N.E.2d at 675.

[112]INDIANA CODE § 4-22-1-17 permits a person seeking judicial review to obtain a stay of an agency's action pending decision by the court. IND. CODE § 4-22-1-17 (Supp. 1985). To obtain the stay, however, a bond must be posted and the court must find that the petition for stay shows a "reasonable probability" that the agency action pending for review is "invalid or illegal." *Id.* The citizen plaintiff may alternatively seek an injunction to prevent the permit's issuance. See *infra* text accompanying notes 215-17 for the reason the wise citizen plaintiff will seek to enjoin the permit's issuance. See also *infra* notes 213-14 and accompanying text which discuss what the citizen plaintiff would have to plead to obtain an injunction.

[113]166 Ind. App. 563, 337 N.E.2d 521 (1975).

[114]IND. CODE § 13-6-1-1 to -6 (1982 & Supp. 1985). See *supra* text accompanying notes 62-69 for a discussion of this statute.

[115]*Sekerez*, 166 Ind. App. at 565, 337 N.E.2d at 523.

[116]IND. CODE § 13-6-1-1(b) (Supp. 1985). *See supra* text accompanying note 67.

[117]*See supra* note 4.

[118]166 Ind. App. at 566, 337 N.E.2d at 523.

[119]*Id.* at 565-67, 337 N.E.2d at 522-24.

judicial review of the order rather than proceed directly to court with his citizen suit.[120]

The *Town of Bremen* court relied on *Sekerez* to support the proposition that the plaintiffs' relief was limited to that prescribed by the AAA, and that it could not render a decision foreclosing that exclusive means to seek redress.[121] The court stated that, "[h]aving previously held that a person is required to pursue relief in such a case as this via the AAA," it would be "incongruous" to decide that plaintiffs had no standing to bring an action for judicial review under that Act.[122] The *Sekerez* case, however, was distinctly different from *Town of Bremen*. *Sekerez* was not "such a case as this."

Sekerez is not useful precedent for resolving the *Town of Bremen* standing issue for three reasons. First, the administrative actions in each case were very different. In *Sekerez*, a final order had been issued; a final order is clearly reviewable under the AAA and the EMA.[123] In *Town of Bremen*, no final order had been issued; rather, the EMB had merely issued a permit to a facility that had met its standards for permit issuance.[124] Second, the relationship between Sekerez and the agency action (issuance of an administrative order), was dissimilar to the relationship between the *Town of Bremen* plaintiffs and that agency action (issuance of a permit). Under the citizen suit statute, Sekerez explicitly had standing to bring an action for judicial review of the order because he was the complainant who initiated the Air Board's investigation and subsequent order. Indiana Code section 13-6-1-1 states, "[t]he complainant shall be joined as a *party* [to the agency's action]."[125] The *Town of Bremen* plaintiffs, however, were not parties to the administrative licensing procedure, but had merely been given the opportunity to express their concerns at the public hearing.[126]

Finally, *Sekerez* should not have controlled in *Town of Bremen* because the injuries asserted in each case were quite distinct. In *Sekerez*, the facility had been in operation and was actively causing the alleged measurable pollution.[127] In *Town of Bremen*, the facility had not yet begun

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[120] *Id.* at 571, 337 N.E.2d at 526.

[121] 458 N.E.2d at 674.

[122] *Id.*

[123] See IND. CODE § 4-22-1-14 (Supp. 1985) and IND. CODE § 13-7-17-1 (Supp. 1985), which both state that any person aggrieved by an agency's final order may obtain judicial review. Although not the case in *Sekerez*, an administrative agency generally issues an order after an adjudicatory hearing has been held. *See* IND. CODE § 4-22-1-12 (Supp. 1985). A member or representative of the agency conducts the administrative adjudicatory hearing then proposes a recommended order to the agency. *Id.* If the agency adopts the recommended order, it becomes the agency's final order. *Id.*

[124] 458 N.E.2d at 673.

[125] IND. CODE § 13-6-1-1(b) (Supp. 1985) (emphasis added).

[126] 458 N.E.2d at 673.

[127] 166 Ind. App. at 565, 337 N.E.2d at 523.

to operate when the objections were made; thus, no pollution of the environment had occurred, nor was damage certain to result.[128] There was an allegation of a present, concrete injury in *Sekerez*; the alleged injury in *Town of Bremen* would only have occurred at some point in the future, if it occurred at all. Therefore, the grant of standing to seek review of an administrative agency's action in *Sekerez* is not persuasive support for an identical result in *Town of Bremen*.

The *Town of Bremen* court relied on one other case as primary authority for its decision, *State ex rel. Calumet Nat'l Bank v. McCord*.[129] *McCord*, however, is also unpersuasive, and not relevant to the standing issue raised in *Town of Bremen*.

In *McCord*, the Calumet National Bank had brought an action in mandate to compel the Indiana Department of Financial Institutions to revoke a permit it had granted the Bank of Whiting to establish a branch bank in Highland, Indiana.[130] The Calumet National Bank had contended that the permit had been wrongfully issued.[131] The court held that the mandate action to compel revocation of the permit could not be maintained; the Calumet National Bank's exclusive remedy was an action for judicial review of the permit's issuance pursuant to the AAA.[132]

The *Town of Bremen* court cited *McCord* to support its conclusion that an agency-specific statute applies only to the initial license determination, and that the AAA prevails thereafter.[133] The EMA, which is the EMB's agency-specific enabling statute, and the AAA, however, use the same "aggrievement" standard to determine standing to bring an action for judicial review.[134] Therefore, it is of no consequence which statute is applied to determine whether a plaintiff has standing because both statutes require aggrievement.

Most importantly, the *McCord* court did not *decide* the standing issue. The sole issue on appeal was whether an action for judicial review of the branch bank license was the Calumet National Bank's exclusive remedy.[135] The *McCord* court held that it was.[136] The Calumet bank was thus barred from obtaining judicial review because the fifteen-

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[128]458 N.E.2d 673.

[129]243 Ind. 626, 189 N.E.2d 583 (1963).

[130]*Id.* at 628, 189 N.E.2d at 584.

[131]*Id.*

[132]*Id.* at 634-35, 189 N.E.2d at 587. The *McCord* court applied the predecessor of IND. CODE § 4-22-1-14. *See* 1947 Ind. Acts 1451. Any difference between IND. CODE § 4-22-1-14 (Supp. 1985) and its predecessor is inconsequential for purposes of this analysis because both require that a person be "aggrieved" before he may obtain judicial review of an agency's action. *Compare* IND. CODE § 4-22-1-14 (Supp. 1985) *with* 1947 Ind. Acts 1451.

[133]458 N.E.2d at 674.

[134]IND. CODE § 4-22-1-14 (Supp. 1985); IND. CODE § 13-7-17-1 (Supp. 1985).

[135]243 Ind. at 630-31, 189 N.E.2d at 585.

[136]*Id.* at 634-35, 189 N.E.2d at 587.

day time period during which a petition for judicial review may be filed had run.[137] Therefore, the *McCord* court disposed of the case without determining whether the Calumet bank would have met the aggrievement standing requirement of Indiana Code section 4-22-1-14 had a petition for judicial review been timely filed. The *McCord* court did not hold that the Calumet bank had standing to appeal the permit's issuance. Therefore, the *Town of Bremen* court failed to recognize what *McCord* did *not* decide.

The *Town of Bremen* court did not merely misconstrue precedent, but also engaged in questionable statutory interpretation. The court broadly interpreted Indiana Code section 13-7-17-1 as a "catch-all" provision of the EMA which "allows any aggrieved person to obtain judicial review of a decision by the [Indiana Environmental Management Board]."[138] This interpretation led the court to conclude that the adjoining and neighboring landowners and the Town of Bremen had standing to pursue an action for judicial review of the EMB's decision to issue a sanitary landfill permit to Indiana Waste Systems, Inc.[139] The court, however, made two errors in reaching this conclusion. First, it failed to recognize the significance of the term "aggrieved" in the code section.[140] Second, by interpreting this provision so broadly, the court rendered code section 13-7-10-4 meaningless.[141] This error is particularly disturbing because section 13-7-10-4 specifically sets forth procedures and standards for appeals from environmental agency decisions to issue or deny permits.[142]

Indiana Code section 13-7-17-1 states that "[a]ny person *aggrieved* by any final order or determination of the [sic] one (1) of the boards may proceed under IC 4-22-1 [the AAA] to obtain a judicial review."[143] According to Indiana's rules of standing, which are applicable to administrative proceedings,[144] an aggrieved person is not merely dissatisfied; he has sustained an injury in fact.[145] The court never discussed the plaintiffs' alleged injury nor its sufficiency for standing purposes.

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[137]*Id.* at 630-31, 189 N.E.2d at 585.

[138]458 N.E.2d at 674-75.

[139]458 N.E.2d at 675. Having decided that the suit was properly before it, the court then found that one AAA provision, IND. CODE § 4-22-1-25, granted the *Town of Bremen* plaintiffs certain due process rights in the permit issuance procedure and that they had been denied those rights. *Id.*

[140]IND. CODE § 13-7-17-1 (Supp. 1985).

[141]The presumption should be made that the legislature intended to enact an effective statute. *See* State *ex. rel* Boger v. Daviess Circuit Court, 240 Ind. 198, 163 N.E.2d 250 (1959); Perry Civil Township of Marion County v. Indianapolis Power and Light Co., 222 Ind. 84, 51 N.E.2d 371 (1943).

[142]IND. CODE § 13-7-10-4 (1982) (repealed effective July 1, 1986).

[143]IND. CODE § 13-7-17-1 (Supp. 1985).

[144]*See supra* text accompanying note 18.

[145]*See supra* notes 20-21 and accompanying text.

Indiana is one of several states whose courts have been presented with the citizen standing issue as it arises in environmental licensing proceedings. The majority of the decisions rendered

The court would have been hard-pressed to find that the plaintiffs had been injured or would be injured by the landfill. The plaintiffs' assertions that harm would result from the landfill were speculative, while the EMB's conclusion that no injury would occur was more concrete. The adjoining and neighboring landowner plaintiffs alleged that the close proximity of the landfill would cause serious and irreparable injury to their land.[146] The town alleged that the landfill would contaminate the aquifer from which the townspeople draw their drinking water and that such contamination would be "catastrophic."[147] The Indiana legislature, however, vested the responsibility to make the permit issuance decision with the EMB.[148] As a condition precedent to the issuance of a landfill permit by the EMB, the EMB requires that detailed information be collected by the permit applicant and submitted to the EMB's staff.[149] Based on the

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in other states have, however, resolved the standing issue by examining the citizen plaintiff 's alleged injury and determining whether state standing requirements have been satisfied. The majority of these decisions were in favor of the citizen plaintiff. *See, e.g.,* National Wildlife Fed'n v. Cotter Corp., 665 P.2d 598 (Colo. 1983); Concerned Citizens for Calcasieu River and Old Town Bay v. Lake Charles Refining Co., 387 So.2d 1330 (La. Ct. App. 1980); Matter of Lappie, 377 A.2d 441 (Me. 1977); Matter of Int'l Paper Co., 363 A.2d 235 (Me. 1976); Citizens for Rural Preservation v. Robinett, 648 S.W.2d 117 (Mo. Ct. App. 1983); Franklin Township v. Commonwealth Dep't of Envtl. Resources, 499 Pa. 162, 452 A.2d 718 (1982); East Greenwich Yacht Club v. Coastal Resources Management Council, 118 R.I. 559, 376 A.2d 682 (1977); and Hooks v. Texas Dep't of Water Resources, 611 S.W.2d 417 (Tex. 1981). A few courts found that the citizen plaintiff 's alleged injury did not satisfy state standing requirements. *See, e.g.,* Mystic Marinelife Aquarium, Inc. v. Gill, 175 Conn. 483, 400 A.2d 726 (1978); Grove Isle, Ltd. v. Bayshore Homeowners' Ass'n, 418 So.2d 1046 (Fla. Dist. Ct. App. 1982); and Wisconsin's Envtl. Decade, Inc. v. Wisconsin Dep't of Natural Resources, 115 Wis. 2d 381, 340 N.W.2d 722 (1983).

[146]Brief for Appellee Dale Sherk at 17-18, Indiana Envtl. Management Bd. v. Town of Bremen, 458 N.E.2d 672.

[147]Brief for Appellee Town of Bremen at 2-3, Indiana Envtl. Management Bd. v. Town of Bremen, 458 N.E.2d 672.

[148]The EMB has the authority to enact regulations containing requirements and procedures for sanitary landfill permits. IND. CODE § 13-7-10-1 (1982) (amended by Pub. L. No. 143-1985, § 147 (effective July 1, 1986)). The EMB has enacted such regulations. *See* 330 IND. ADMIN. CODE 4-1-1 to 4-9-5 (1984). Although the 1985 amendment to the EMA reorganized the EMB and renamed it the Solid Waste Management Board, the regulations previously enacted by the EMB continue in effect and are to be treated as rules of the Solid Waste Management Board. *See* Pub. L. No. 143-1985, § 209 (a non-code section).

[149]An application for a sanitary landfill construction permit must be accompanied by, *inter alia*: (1) a topographical map; (2) a map which depicts present land use, including locations of wells, sewers, drainage tiles, surface water, water courses, and roads; (3) plot plans drawn to scale which depict, among other things, water courses, surface water, soil boring locations, surface water runoff direction, fences, present land surface contour, storm water drainage during and after operation, areas where wastes will be deposited, and depth of waste deposits; (4) geographical drawings which show types of materials from the ground surface to and including bedrock, and depth of water table; (5) reports of soil, groundwater, and geology including analysis of soil borings taken at a depth of at least twenty feet below the lowest level of proposed excavation or to bedrock; and (6) a narrative of

information submitted, the EMB's staff, recognized as the technical experts in these matters,[150] had determined that the Prairie View Landfill would not damage the environment.[151] Thus, the plaintiffs' assertions that harm would result from the landfill's operation were speculative at best.

The court made its second statutory interpretation error by focusing on section 13-7-17-1 and refusing to recognize the relevance of section 13-7-10-4 to the standing issue presented. The *Town of Bremen* court's interpretation of section 13-7-17-1 renders section 13-7-10-4 meaningless even though it is the only statutory provision that addresses appeals from environmental permit decisions. If the legislature had truly intended that anyone could seek judicial review of any EMB action pursuant to section 13-7-17-1, the judicial review provision in section 13-7-10-4 would be superfluous.[152]

The EMB and Indiana Waste Systems, Inc. asserted that the controversy should have been resolved by applying section 13-7-10-4, a statutory provision that specifically pertains to appeals from permit issuances and denials.[153] The court acknowledged that it had been urged to apply this provision.[154] The court, nevertheless, refused to do so.[155] Instead, the court broadly interpreted section 13-7-17-1 and held that the *Town of Bremen* plaintiffs had standing to bring an action for judicial review of the permit issuance.[156] Section 13-7-10-4, however, was the more appropriate EMA provision for resolving the standing issue. That section provides:

> (a) If a permit is denied or if the permit is issued with terms and conditions which are objectionable to the applicant, the applicant may petition for a hearing before the board or appropriate agency within fifteen (15) days after the date of receipt

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the proposed operation including procedures for dust, rodent, insect, leachate, and methane gas control. 330 IND. ADMIN. CODE 4-3-4 (1984).

[150]An administrative agency possesses special knowledge in the field over which it has jurisdiction. Board of Medical Registration and Examination of Indiana v. Armington, 242 Ind. 436, 440, 178 N.E.2d 741, 743 (1961); Indiana Dep't of Public Welfare v. Crescent Manor, Inc., 416 N.E.2d 470 (Ind. Ct. App. 1981); Capital Improvement Bd. of Managers of Marion County v. Public Service Comm'n, 176 Ind. App. 240, 375 N.E.2d 616 (1978).

[151]After reviewing the application, the EMB must determine whether the site and proposed operation are compatible with the public health and environment. 330 IND. ADMIN. CODE 4-3-5 (1984). The permit must be denied unless a positive determination is made. *Id.*

[152]*Compare* IND. CODE § 13-7-17-1 (Supp. 1985) *with* IND. CODE § 13-7-10-4 (1982) (repealed effective July 1, 1986).

[153]Brief for Appellant Indiana Environmental Management Board at 14-16, Brief of Appellant Indiana Waste Systems, Inc. at 10-12, Appeal from the LaPorte Circuit Court, Indiana Envtl. Management Bd. v. Town of Bremen, 458 N.E.2d 672.

[154]*Town of Bremen*, 458 N.E.2d at 674.

[155]*Id.*

[156]*Id.* at 674-75.

> of the permit or notice of a denial of permit. Such a petition which is timely and which complies with any other requirements of the board or appropriate agency shall be granted. A person aggrieved by the denial of a petition for hearing or by the denial or issuance of a permit after hearing may seek judicial review thereof pursuant to IC 13-7-17. For the purposes of making such an appeal, the date of denial of the petition for hearing under this section is the date of the final determination of the board or agency.
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> (b) At a hearing under this chapter, the petitioner has the burden of proving to the board or agency:
>
> (1) why the permit should be issued; or
>
> (2) why the terms and conditions of the permit are not justified or are otherwise invalid.
>
> (c) The board or appropriate agency may designate a person to be a hearing officer. Except as provided in this section, hearings shall be conducted under IC 4-22-1.[157]

The adjoining and neighboring landowner plaintiffs recognized that the first sentence of subsection (a) grants the permit applicant the right to an adjudicatory hearing to contest a permit denial or a permit issuance when the permit is issued with objectionable terms.[158] These plaintiffs further asserted, however, that subsection (a)'s third sentence allows *any* person aggrieved by the permit issuance or denial to appeal because that sentence says "person" rather than "applicant."[159] The EMB and Indiana Waste Systems argued that this provision allows only the permit applicant to appeal from the denial or issuance of a permit.[160]

Examination of the predecessor of code section 13-7-10-4 reveals that the EMB and Indiana Waste Systems were correct. The earlier provision read:

> If a permit is *refused* by staff, notice of such *refusal* shall be mailed by the United States mail, postage prepaid, to the applicant at the address stated in his application, and the applicant may petition for a hearing before the board or agency at any time within fifteen (15) days after the date of mailing of the notice of refusal of the permit. The burden shall be upon the petitioner

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[157]IND. CODE § 13-7-10-4 (1982) (repealed effective July 1, 1986).

[158]Brief for Appellee Dale Sherk at 13, Indiana Envtl. Management Bd. v. Town of Bremen, 458 N.E.2d 672.

[159]*Id.* at 13-14.

[160]Brief for Appellant Indiana Environmental Management Board at 15-16, Brief for Appellant Indiana Waste Systems, Inc. at 11-12, Appeal from LaPorte Circuit Court, Indiana Envtl. Management Bd. v. Town of Bremen, 458 N.E.2d 672.

> to justify the *issuance* of the permit. The hearing may be conducted by a person designated by the board or agency to conduct such hearing, and the administrative adjudication act shall apply.[161]

Comparison of the previous provision with the current one clearly demonstrates that the issuance of a permit was added as grounds for judicial review. The prior statute only allowed judicial review if a permit was "refused."

Careful analysis yields a valid reason why the legislature added the issuance of a permit as grounds for appeal. A permit may be issued with terms so objectionable to the permittee that it would be tantamount to a permit denial. For example, air and water pollution control facility operation permits contain discharge limitations. These facilities may not discharge air or water containing pollutants above the permit limits. If such limits could not be achieved by the permittee, the agency action constitutes the practical equivalent of a permit denial. In all fairness, an agency should not require that a permittee accept such a condition without recourse. Thus, the legislature amended code section 13-7-10-4 to allow a permit applicant to petition for an administrative adjudicatory hearing on the matter of a permit "issued with terms and conditions which are objectionable to the applicant." Therefore, the term "issuance" in subsection (a)'s third sentence does not refer to *any* permit issuance; instead, the term "issuance" means the issuance of a permit which has terms and conditions objectionable to the *applicant*.

The present wording of section 13-7-10-4(b) further demonstrates that the legislature intended that only the applicant be entitled to appeal the issuance or denial of a permit. The petitioner for the hearing must, at the hearing, prove either that the permit should be issued or that the permit's terms and conditions are unjustified or invalid.[162] The legislature's addition of the latter burden of proof to the earlier version of this provision is consistent with its addition of the issuance of a permit with objectionable terms as a ground for appeal.[163] The citizen objector would not want to prove why the permit should be *issued*. The tenor of the second burden of proof indicates that its application is more appropriate when the petitioner seeks modification of a particular permit provision, rather than invalidation of the entire permit.[164] If the legislature had intended that citizen objectors be allowed to challenge the issuance of environmental permits, it could easily have added a third burden of proof — that

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[161] 1972 Ind. Acts 555 (emphasis added).

[162] IND. CODE § 13-7-10-4(b) (1982) (repealed effective July 1, 1986).

[163] *Compare* 1972 Ind. Acts 555 *with* IND. CODE § 13-7-10-4 (1982) (repealed effective July 1, 1986).

[164] *See* IND. CODE § 13-7-10-4(b)(2) (1982) (repealed effective July 1, 1986).

the permit should *not* be issued.[165] In sum, the *Town of Bremen* court applied and misinterpreted a broad statutory provision, Indiana Code section 13-7-17-1, rather than apply and interpret code section 13-7-10-4, the only statutory provision which specifically relates to appeals from the issuance or denial of environmental permits. Had the court applied the more appropriate statute, it may have reached a different result.

The court committed a third statutory interpretation error because it did not fully apply code section 4-22-1-25. The EMB and Indiana Waste Systems had contended that the LaPorte Circuit Court erred in finding that the *Town of Bremen* plaintiffs were entitled to an adjudicatory hearing on the matter of the permit issuance.[166] The court disagreed with this characterization of the trial court's findings.[167] The appellate court found, instead, that the trial court only held that the EMB had failed to provide the plaintiffs with the proper notice and an opportunity to settle as required by this section.[168] The court, however, overlooked the last sentence of section 4-22-1-25 which states, "[i]n the event no adjustment or settlement is so arrived at, then proceedings and *hearings* shall be had as provided in [the AAA]."[169] The only hearing provided for in the AAA is an administrative adjudicatory hearing.[170] Therefore, the court failed to recognize that its application of this provision to the *Town of Bremen* facts entitles the *Town of Bremen* plaintiffs and all other similarly situated citizen objectors to an adjudicatory hearing on the matter of a permit's issuance and to judicial review if the decision after the hearing is adverse to the citizen objector.[171]

Finally, the court overlooked two remedies available to the *Town of Bremen* plaintiffs should their fears that the landfill would cause them harm be realized. First, they could bring a nuisance suit.[172] Second, the

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[165]What a statute does not say is just as important as what it does say. Van Orman v. State, 416 N.E.2d 1301 (Ind. Ct. App. 1981); State *ex rel* Schuerman v. Ripley County Council., 182 Ind. App. 616, 395 N.E.2d 867 (1979).

[166]Indiana Envtl. Management Bd. v. Town of Bremen, 458 N.E.2d at 675.

[167]*Id.*

[168]*Id.*

[169]IND. CODE § 4-22-1-25 (Supp. 1985) (emphasis added).

[170]*See* IND. CODE §§ 4-22-1-1 to -30 (1982 & Supp. 1985).

[171]Any party or person aggrieved by an order issued after the hearing, or a determination made after the hearing, is entitled to bring an action for judicial review of that order or determination. IND. CODE § 4-22-1-14(a) (Supp. 1985).

[172]A nuisance is defined as "whatever is injurious to health, or indecent, or offensive to the senses, or an obstruction to the free use of property, so as to essentially interfere with the comfortable enjoyment of life or property." IND. CODE § 34-1-52-1 (1982). Possession of a license to conduct an activity is no defense to an action that alleges the activity constitutes a nuisance. Haggart v. Stehlin, 137 Ind. 43, 35 N.E. 997 (1893); Price v. Grose, 78 Ind. App. 62, 133 N.E. 30 (1921). A nuisance action may be brought by any person whose property is injuriously affected or whose personal enjoyment of the property is lessened

citizen suit provision of the EMA would be available as a form of redress.[173]

Perhaps an underlying reason for the court's decision is the apparent lack of faith the public has in our environmental agencies and their decisions.[174] This is not a sufficient reason, however, for the *Town of Bremen* result.

D. The Town of Bremen *Decision's Impact*

Prior to *Town of Bremen*, the environmental agencies issued and denied permits under the assumption that only the permit applicants had standing to contest the agency's permit decisions.[175] The permit issuance procedure was thought to involve only two entities — the entity seeking the permit, the permit applicant, and the entity issuing or denying the permit, the environmental agency.[176] *Town of Bremen* introduces a third entity whose interests must now be considered — the citizen objector.

The *Town of Bremen* decision will have a tremendous impact on state environmental licensing procedures, and some consequences may be unintended. The greatest impact will be felt by the permit applicants and environmental agencies. Under *Town of Bremen*, the licensing procedure is extremely complex and will entail an inordinate period of time from the date of permit application to the date of ultimate permit issuance or denial.[177] The permit applicant must now await the outcome of each successive procedural step that must be afforded a citizen objector. At a minimum, each agency must provide citizens a public hearing on

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by the nuisance, or by the attorney of any county, city, or town in which a nuisance exists. IND. CODE § 34-1-52-2 (Supp. 1985).

[173]IND. CODE § 13-6-1-1 (Supp. 1985); *see supra* text accompanying notes 62-69. A citizen suit may also be instituted when injury is merely threatened. IND. CODE § 13-6-1-2 (Supp. 1985).

[174]The Governor created the Environmental Policy Commission to hold public hearings throughout the state and to study present environmental problems. Exec. Order No. 16-83, 7 Ind. Reg. 248-49 (1983). The Commission was charged with the duty to make recommendations regarding, *inter alia*, alternative organizational structures for managing the state's environmental programs. *Id.* at 248.

The 1985 Indiana General Assembly implied that the state's present system for environmental protection is inadequate when it stated, in its preamble to the legislation that reorganizes the primary environmental agencies, that a separate state agency devoted entirely to environmental protection is both desirable and necessary. Pub. L. No. 143-1985.

[175]Interview with Brenda Franklin Rodeheffer, Deputy Attorney General, Indiana Attorney General's Office (Aug. 1, 1985). Mrs. Rodeheffer was one of the EMB's attorneys in the *Town of Bremen* litigation. Throughout the course of that litigation, Mrs. Rodeheffer was chief of the Attorney General's Environmental Section, which represents every state environmental agency.

[176]*Id.*

[177]*See infra Town of Bremen* procedure chart (Chart One) at the end of this Note.

request,[178] notice of the initial permit issuance determination,[179] fifteen days to object to that determination,[180] and an opportunity to settle.[181] A non-settling citizen plaintiff may further pursue his procedural rights in an administrative adjudicatory hearing,[182] an action for judicial review of the administrative hearing result,[183] and an appeal from the judicial review action.[184]

Agency resources are currently insufficient, and the new procedure will require devotion of much time by personnel of the EMB and other presently understaffed agencies.[185] Agency personnel will be involved at every step in the *Town of Bremen* scheme. Agency staff will conduct the public hearing and respond to comments made, as they did prior to *Town of Bremen*. They will now also determine the identity of all who may be affected by a permit's issuance and send the required notices. Agency staff will participate in any settlement conference and will be witnesses in any administrative adjudicatory hearing held.

The agencies will have a difficult task in satisfying the notice requirement alone because the *Town of Bremen* court failed to give them any guidance in determining who is entitled to participate in a licensing proceeding. The court never discussed how and why the *Town of Bremen* plaintiffs were aggrieved by the EMB's issuance of a permit to Indiana Waste Systems. The agencies must now identify the persons who may be affected by the permit issuance and give them notice by certified mail or in person.[186] In *Town of Bremen*, affected persons included everyone who drew water from the aquifer below the landfill.[187] An aquifer, however, can involve the subsurface geology of several Indiana counties. In the case of an air pollution discharge permit, the persons affected may differ with the direction of the air currents and may include persons in other states or countries.[188] We all breathe air from the same atmosphere

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[178]IND. CODE § 13-7-10-2 (Supp. 1985).

[179]IND. CODE § 4-22-1-25 (Supp. 1985); *Town of Bremen*, 458 N.E.2d at 675.

[180]IND. CODE § 4-22-1-25 (Supp. 1985); *Town of Bremen*, 458 N.E.2d at 675.

[181]IND. CODE § 4-22-1-25 (Supp. 1985); *Town of Bremen*, 458 N.E.2d at 675.

[182]IND. CODE § 4-22-1-25 (Supp. 1985).

[183]IND. CODE § 4-22-1-14 (Supp. 1985); IND. CODE § 13-7-17-1 (Supp. 1985); 458 N.E.2d at 674-75.

[184]IND. CODE § 4-22-1-19 (1982).

[185]Testimony of State Board of Health management at Environmental Policy Commission hearing on August 15, 1984.

[186]IND. CODE § 4-22-1-25 (Supp. 1985).

[187]*See supra* note 105 and accompanying text.

[188]The Canadian government has complained loudly and often that United States sulfur dioxide air emissions, especially those from the Midwest, cause acid rain in Canada. *See generally*, Lucas, *Acid Rain: The Canadian Position*, 32 U. KAN. L. REV. 165 (1983); Comment, *Who'll Stop the Rain: Resolution Mechanisms for U.S.-Canadian Transboundary Pollution Disputes*, 12 DEN. J. INT'L L. & POL'Y 51 (1982).

and this relationship is no more tenuous than drinking water from an aquifer that is threatened with contamination. Thus, the notice requirement poses a serious problem for the orderly issuance of permits. Any person who believes himself affected by the permit issuance and who does not receive notice of the impending permit issuance will, under *Town of Bremen*, be able to invoke his procedural rights at any time because, under Indiana Code section 4-22-1-25, the period during which objections may be filed does not begin to run until after notice is received.

The average consumer will also not escape the effects of *Town of Bremen*. The permit applicant will be involved in each step of the lengthy process, which will inevitably increase the start-up cost for a new facility. The applicant's legal fees alone will significantly increase start-up costs because the applicant will need legal representation at each administrative and judicial proceeding available to the citizen plaintiff. The increased cost for the applicant will result in increased disposal fees, which in turn will be passed on to the consumers of the goods and services whose production generates the wastes to be disposed of at the new facility. Consumers will also indirectly pay for the extensive legal services necessary to represent the environmental agencies because the agencies' attorneys are paid with state tax revenues.[189]

An unintended potential result of *Town of Bremen* is that landfills and other types of environmental facilities will be located in or near communities that do not have the resources to finance the extensive, long-term legal representation required to pursue the administrative and judicial rights available to them. Thus, the poorer areas of the state might be saddled with a disproportionate share of the facilities necessary to treat and dispose of wastes generated by others.

The *Town of Bremen* public participation scheme may actually have several adverse environmental and human health consequences. First, the agencies may be compelled to spend a significant portion of their resources justifying their permit decisions throughout the *Town of Bremen* procedure. In the event that these agencies' budgets and staffing levels are not increased,[190] routine monitoring of compliance, and effective enforcement against noncompliance by existing facilities may suffer. Second, it is undisputed that wastes are generated every day and must be disposed of safely. The tremendous delay in the licensing of legitimate environmental facilities may encourage illegal and unsafe disposal when no legal alternative exists. Third, because the authorization of new facilities may be significantly delayed, or in some cases foreclosed, existing facilities will necessarily be used instead. There is no guarantee that the existing facilities

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[189]The Indiana Attorney General represents every state agency. IND. CODE § 4-6-2-1 (1982). That office is funded, for the most part, by appropriations from the state's general revenues. IND. CODE § 4-13-2-18 (Supp. 1985).

[190]*See supra* text accompanying note 185.

are safer than the proposed facilities.[191] In fact, some existing environmentally-related facilities have been "grandfathered" into the new pollution control regulatory schemes, and thus are not required to meet the new, more stringent standards.[192] Finally, the *Town of Bremen* procedure, if used by citizen plaintiffs to the fullest extent, may result in judicial decisions displacing the technical experts' analyses because judges will be dispensing the ultimate stamp of approval or disapproval on environmental permits.[193]

IV. The Legislative Response to *Town of Bremen*

The 1985 Indiana General Assembly enacted legislation[194] that reorganizes the state's three primary environmental agencies.[195] This legislation also attempts to streamline the troublesome *Town of Bremen* permit issuance procedure.[196] However, the legislature may have unwittingly added a new set of problems to those created by the *Town of Bremen* decision, while leaving the existing faults unremedied.

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[191]The city of Indianapolis, Indiana, is now facing such a waste disposal dilemma. In December of 1984, the City proposed four possible sites for a new landfill. Indianapolis Star, Dec. 5, 1984, at 1, col. 1. The public uproar was tremendous. *See, e.g., Landfill Opponents Vow to Fight Plan*, Indianapolis Star, Jan. 11, 1985 at 9, col. 1; *Vocal Crowd at Hearing Firm in Opposition to Landfill*, Indianapolis Star, Jan. 18, 1985, at 15, col. 1; *Warren Township Takes on City at Landfill Hearing*, Indianapolis Star, Jan. 23, 1985, at 45, col. 5; *Decatur Township Residents Dispute Proposed Landfill Site*, Indianapolis Star, Jan. 24, 1985, at 1, col. 5. The City bowed to public pressure and scrapped its plan to build a new landfill in Marion County. Indianapolis Star, Feb. 12, 1985, at 1, col. 1. The City continues to use an existing landfill, which may be contaminating an underlying aquifer. Indianapolis Star, Dec. 6, 1984, at 19, col. 1. Furthermore, the landfill is almost full. *Too Much Trash Results in Early Closure of Landfill*, Indianapolis News, Apr. 10, 1985, at 1, col. 1. The City if also facing increased wast disposal costs because of the shortage of available landfill space. *State Threatens to Close Landfill, Forcing City's Trash Costs to Rise*, Indianapolis Star, June 22, 1985, at 33, col. 3.

[192]For example, the requirement that a certificate of environmental compatibility be obtained does not apply to hazardous waste disposal facilities proposed or in operation at the time the Solid Waste Facility Site Approval Authority was created. *See* Ind. Code § 13-7-8.6-5 (1982).

[193]*See infra Town of Bremen* procedure chart (Chart One) at the end of this Note.

[194]Pub. L. No. 143-1985.

[195]These primary agencies are the Air and Water (formerly Stream) Pollution Control Boards and the Solid Waste Management Board (formerly Environmental Management Board).

[196]See Pub. L. No. 143-1985, § 149, which adds a new provision to the EMA (codified at Ind. Code § 13-7-10-2.5 (Supp. 1985)). In the interest of reader comprehension, this section is reprinted here in its entirety:

> (a) In response to an application for an original permit or a renewal permit, the commissioner:
> (1) shall, if required by section 2(b) of this chapter or other law, or may, if not required by law;
> (2) publish a notice requesting comments concerning the question of issuance or denial of the permit. A comment period of at least thirty (30) days must follow

The new permit issuance procedure is significantly different from the *Town of Bremen* scheme. After the public hearing,[197] or after a public

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publication of a notice under this section. During the comment period, interested persons may submit written comments to the commissioner concerning the issuance or denial of the permit, and may request a public hearing concerning the issuance or denial of the permit. The commissioner, in response to one (1) or more written requests, may hold a public hearing in the geographical area affected by the proposed permit on the question whether to issue or deny the permit.

(b) After the comment period or, if a public hearing is held, after the public hearing, the commissioner shall issue the permit or deny the permit application. Unless the commissioner, in writing, states otherwise, the commissioner's action under this section is effective immediately. Notice of the commissioner's action shall be served upon:

(1) the permit applicant;

(2) each person who submitted written comments under subsection (a); and

(3) each person who requests notice of the permit determination.

If the commissioner's action is likely to have a significant impact upon persons who are not readily identifiable, the commissioner may publish notice of the action on the permit application in a newspaper of general circulation in the county affected by the proposed permit.

(c) Within fifteen (15) days after receiving the notice provided by the commissioner under subsection (b):

(1) the permit applicant; or

(2) any other person aggrieved by the commissioner's action;

may appeal the commissioner's action to the appropriate board and request that the board hold an adjudicatory hearing concerning the action under IC 4-22-1.

(d) a written request for an adjudicatory hearing under subsection (c) must:

(1) state the name and address of the person making the request;

(2) identify the interest of the person making the request;

(3) identify any persons represented by the person making the request;

(4) state with particularity the reasons for the request;

(5) state with particularity the issues proposed for consideration at the hearing; and

(6) identify the permit terms and conditions which, in the judgment of the person making the request, would be appropriate in the case in question to satisfy the requirements of the law governing permits of the type granted or denied by the commissioner's action.

(e) Within thirty (30) days after receiving a request for an adjudicatory hearing, the board, if it determines that the request was properly submitted and that it establishes a jurisdictional basis for a hearing, shall assign the matter for a hearing. Upon assigning the matter for a hearing, the board may stay the force and effect of any contested permit provision and any permit term or condition the board considers inseverable from a contested permit provision. After a final hearing under this subsection, a final order of the board on a permit application is subject to review under IC 4-22-1.

Id. This provision takes effect on July 1, 1986. Pub. L. No. 143-1985, § 212. Discussion of the legislative changes made in the *Town of Bremen* procedure will be primarily limited to those affecting permit issuances.

[197]A public hearing need not always be conducted by the agencies. Under the existing procedure, a public hearing regarding the potential issuance of a permit for a solid waste or hazardous waste disposal facility must be held when requested by certain persons. IND. CODE § 13-7-10-2(b) (Supp. 1984). *See supra* text accompanying notes 52-56 and 98-101. Under the new procedure, an interested person may request a public hearing regarding the potential issuance of any type of permit by submitting a written comment which makes

comment period,[198] the Commissioner[199] "*shall* issue or deny the permit application."[200] Unless the Commissioner states otherwise, his decision to issue or deny the permit is "effective *immediately.*"[201] Thus, the permit applicant has his permit in hand *before* any citizen may make an objection.

The Commissioner must then serve notice of the permit's issuance on the applicant, persons who submitted written comments on the question of permit issuance, and persons who requested such notice.[202] The Commissioner also has the discretion to publish a notice of the permit's issuance "in a newspaper of general circulation in the county affected by the proposed permit" if his decision to issue the permit is "likely to have a significant impact upon persons who are not readily identifiable."[203]

The permit applicant or "any other person aggrieved" may then appeal the permit's issuance within fifteen days after the notice of its is-

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such a request. Pub. L. No. 143-1985, § 149 (codified at IND. CODE § 13-7-10-2.5(a) (Supp. 1985)). A public hearing request made under this provision, however, does not mandate that the hearing be conducted; the permit issuance authority has the discretion to grant the request. *Id.*

[198]The new law also allows the permit issuance authority to institute a comment period during which written comments may be submitted on the question of permit issuance. Pub. L. No. 143-1985, § 149 (codified at IND. CODE § 13-7-10-2.5(a) (Supp. 1985)). The opening of such a comment period appears to be purely discretionary. The new law states that the permit issuance authority must publish a notice requesting comments when IND. CODE § 13-7-10-2(b) so requires. *Id.* The referenced section, however, does not require that any public notice be issued. IND. CODE § 13-7-10-2(b) (Supp. 1985), *amended by* Pub. L. No. 143-1985, § 149.

[199]Under the reorganization law, the Commissioner of the newly-created Department of Environmental Management, as the Department's executive and chief administrative officer, makes the ultimate decision whether to issue or deny a permit. *See* Pub. L. No. 143-1985, § 97 (codified at IND. CODE § 13-7-2-12 (Supp. 1985)), and Pub. L. No. 143-1985, § 107 (codified at IND. CODE § 13-7-3-9 (Supp. 1985)).

[200]Pub. L. No. 143-1985, § 149 (codified at IND. CODE § 13-7-10-2.5(b) (Supp. 1985)) (emphasis added).

[201]*Id.* (emphasis added).

[202]*Id.*

[203]*Id.* This particular provision has several potential problems. First, at this stage in the procedure, the permit is not "proposed"; the permit has been issued and, unless the Commissioner states otherwise, is immediately effective. *See supra* text accompanying note 201. Second, the provision uses the phrase "*the* county affected" which implies that, if the Commissioner chooses to publish the notice, he need only do so in one county, presumably the county in which the facility will be located. A facility may, however, affect persons in more than a single county. *See supra* text accompanying notes 186-88. *See also infra* note 240 and accompanying text. Third, by defining these persons as those upon whom the permit issuance decision "*is likely* to have a *significant* impact," the legislature has, in effect, stated that these persons are persons "aggrieved" under IND. CODE §§ 4-22-1-14 (AAA) and 13-7-17-1 (EMA). Consequently, they would be entitled to bring an action for judicial review of the permit's issuance. *See* IND. CODE §§ 4-22-1-14 (Supp. 1985), and 13-7-17-1 (1985), *amended by* Pub. L. No. 143-1985, § 177. Nevertheless, the Commissioner is not *required* to give these persons notice of his decision to issue the permit, nor will the notice, if issued, necessarily *reach* all "aggrieved" persons because it need only be issued in one county, if it is issued at all. *See* Pub. L. No. 143-1985, § 149 (codified at IND. CODE § 13-7-10-2.5(b) (Supp. 1985)).

suance is received.[204] The new statute thus makes clear that persons other than the permit applicant can be aggrieved by a permit's issuance. The appeal is commenced by a request for an adjudicatory hearing, which will be conducted pursuant to the AAA.[205] Once the matter is assigned for hearing, "the Board[206] may stay the force and effect of any contested permit provision and any permit term or condition the board considers inseverable from a contested permit provision."[207] A final order on a "permit application," issued by the board after the hearing, is subject to judicial review under the AAA.[208] The new permit issuance procedure is roughly diagrammed in Chart Two at the end of this Note. Contingencies not previously discussed are noted to show that the new permit issuance procedure remains at least as complex as the *Town of Bremen* scheme.

The legislature's new permit issuance procedure may create several problems in addition to those engendered by the *Town of Bremen* decision.[209] First, if the permittee is satisfied with the permit he receives and chooses to rely on it as initially issued, he may eventually hold a permit with modified terms that are incompatible with his actions taken in reliance on the initial permit. For example, a citizen may object to the permit and allege that a specific permit provision is too lenient, such as an air pollutant emission limitation. That emission limitation may be stayed[210] or the permit may remain fully effective.[211] If the contested per-

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[204]Pub. L. No. 143-1985, § 149 (codified at IND. CODE § 13-7-10-2.5(c) (Supp. 1985)). Therefore, if an aggrieved person never receives the notice, the fifteen day period never begins to run. Also, if notice is received via newspaper publication, it may be difficult to determine exactly *when* it was received.

[205]*Id.*

[206]Depending on the type permit challenged, either the Air or Water Pollution Control Boards or the Solid Waste Management Board will conduct the hearing. Pub. L. No. 143-1985, § 149 (codified at IND. CODE § 13-7-10-2.5(e) (Supp. 1985)).

[207]Pub. L. No. 143-1985, § 149 (codified at IND. CODE § 13-7-10-2.5(e) (Supp. 1985)).

[208]*Id.* More accurately, the hearing and subsequent order will concern the decision to issue or deny the permit, not the application.

[209]The new legislation's departure from AAA procedure may raise an issue as to its validity. The AAA states that its procedures are to be followed, "*and not otherwise.*" *See* IND. CODE § 4-22-1-3 (1982) (emphasis added). Discussion of whether the legislature may provide for non-AAA procedures in legislation other than that which amends the AAA is not within the scope of this Note. *See also supra* note 50 and accompanying text.

[210]*See supra* text accompanying notes 206-07. The effect of that stay is unclear; either the permittee could not discharge *any* of the pollutant regulated by the contested provision, or he could not discharge that pollutant in excess of the level the citizen objector finds appropriate. *See* Pub. L. No. 143-1985, § 149 (codified at IND. CODE § 13-7-10-2.5(d) (Supp. 1985)), which requires that the request for an adjudicatory hearing, *inter alia*, "identify the permit terms and conditions which, in the judgment of the person making the request, would be appropriate in the case in question to satisfy the requirements of the law governing permits of [the appropriate type]."

[211]The board has the discretion to stay any condition, as evidenced by the legislature's use of the word "may." Pub. L. No. 143-1985, § 149 (codified at IND. CODE § 13-7-10-2.5(e) (Supp. 1985)).

mit condition is not stayed, the permittee may choose to construct his facility before the appeal has been resolved. If he does so, and the citizen ultimately prevails, the permittee may find himself in the unfortunate position of having to comply with a more stringent emission limitation than his facility was designed and constructed to achieve.

Second, if the permittee is not satisfied with the permit he is initially issued and the offensive provisions are not stayed, he no longer has the option to appeal the permit's objectionable terms before the permit becomes fully effective; the permit is effective immediately upon issuance. Therefore, the new permit procedure cuts both ways. Citizen objectors *and* permittees must wait until after the permit is fully effective before they may appeal the issuance of objectionable permits.

Third, the legislature's new permit issuance procedure may present the courts with a choice between two inequitable results. A worst case example will illustrate the dilemma. The Commissioner issues construction and operation permits for air pollution control equipment which will be part of a new automobile manufacturing plant. The permits are effective immediately. Citizens object and allege that the plant will degrade the air quality, especially in view of the location the manufacturer selected. The Air Pollution Control Board does not stay any permit conditions. The manufacturer builds the plant before the appeal procedure reaches finality. Eighteen months after the permits are issued, the adjudicatory hearing officer's decision upholds the permits' issuance. Another year later, the trial court must render a decision in the action for judicial review. The manufacturer has spent X million dollars and employs Y thousand workers in an economically depressed area. If the judge decides the permit should never have been issued, he must fashion a remedy. Does he order the plant closed? Or will he allow the plant to continue to operate because economic and political considerations outweigh the citizens' rights? Where do the equities lie in this situation?

This hypothetical situation demonstrates a fourth problem the new procedure may create. If economic considerations prevail and the court does not order that the polluting activity cease, the permittee has in effect "coerced" the court into making a mockery of the citizen's right to appeal the permit issuance by constructing the facility while the citizen prosecutes his appeal. Another worst case example will further demonstrate this point.

The Commissioner issues a sanitary landfill permit. The permit is effective immediately. Citizens object to the landfill's location and allege that it will contaminate the underlying aquifer from which they draw their drinking water. The Solid Waste Management Board stays no permit provision. The permittee constructs the landfill and receives wastes for three years while the citizens pursue their appeal. After the adjudicatory hearing, the hearing officer upholds the permit's issuance. On judicial review, the court holds that the permit should never have been issued because the citizens' evidence clearly establishes that the site is unsuitable for a

landfill. But the damage has been done; groundwater samples from the aquifer indicate significant contamination. The citizens have won the battle but lost the war. In both worst case scenarios, the citizens' rights are nullified because the permittee has a fully effective permit before and during the appeal's prosecution.[212]

A fifth problem may ensue from the new procedure. Because the new procedure may effectively eliminate the citizens' rights, the prudent citizen objector may bypass it entirely, and immediately before the permit's issuance seek a court-issued injunction enjoining the permit's issuance, or immediately after the permit's issuance seek a court order that stays the entire permit. He could allege that he has no adequate remedy at law, that he will be irreparably harmed if the permit is issued or remains effective,[213] and that it would be futile for him to exhaust his administrative remedies.[214] Therefore, an injunction may be issued under facts similar to these hypotheticals.

The *Town of Bremen* decision encourages the citizen to sue for an injunction before the permit is issued. The plaintiffs in that suit prevailed at the trial court level in a mandamus action brought to compel the EMB to close the Prairie View Landfill after the LaPorte Circuit Court declared its permit void.[215] On appeal, the EMB and Indiana Waste Systems argued that the trial court had no authority to mandate that the EMB close the landfill.[216] In deciding the mandamus issue, the appellate court held that "a court cannot compel the exercise of a discretionary act in any particular manner" and that the revocation of a permit is a discretionary act.[217] Therefore, if the Commissioner issues a permit which a court later holds should never have been issued, that court has no authority to order the Commissioner or any board to revoke the permit. If the administrative authority refuses to revoke the permit, the citizen is without a remedy. Thus, a citizen plaintiff would be wise to attempt to prevent such a situation from arising by suing for an injunction enjoining the permit's issuance.

The legislature's new permit issuance scheme, in addition to creating new problems, fails to remedy several existing deficiencies in the *Town of Bremen* procedure. First, the notice defects are uncured. The statutes

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[212]The AAA states that its purpose is to, *inter alia*, provide an opportunity to be heard. IND. CODE § 4-22-1-1 (1982). The new procedure may make this opportunity a hollow one.

[213]An injunction will be issued when there is no adequate remedy at law and irreparable injury will be done. *See, e.g.*, Rees v. Panhandle E. Pipe Line Co., 176 Ind. App. 597, 377 N.E.2d 640 (1978).

[214]Generally, courts have no jurisdiction to grant relief until all administrative remedies are exhausted. Northside Sanitary Landfill v. Indiana Envtl. Management Bd., 458 N.E.2d 277 (Ind. Ct. App. 1984) (citations omitted). Compliance with this rule is not required, however, when compliance would be futile, or would result in irreparable harm. *Id.*

[215]458 N.E.2d at 673, 676.

[216]*Id.* at 676-77.

[217]*Id.* at 676-77.

underlying the *Town of Bremen* scheme, the EMA and the AAA, do not require that an environmental agency notify the public that it is considering whether to issue a particular permit;[218] notice is only required upon the agency's initial issuance of the permit.[219] The new statutory procedure also contains no provision that requires the environmental agencies to give public notice of the potential permit issuance.[220] This deficiency is especially troublesome and may create additional problems because the requirement that a person be notified of the permit's issuance[221] greatly depends on that person's prior knowledge that the permit was being considered for issuance.[222] Furthermore, the statutory procedure for notifying other affected persons of the permit's issuance may not reach the targeted persons.[223] Thus, an aggrieved person could be unaware of both the potential and actual issuance of the permit. An aggrieved person who is unaware that he is aggrieved cannot assert his rights.

These unremedied notice deficiencies bring about the second problem in the *Town of Bremen* procedure which the legislature failed to address. The fifteen-day period during which an adjudicatory hearing request may be made does not begin to run until the notice has been *received.*[224] Thus, any aggrieved person who never receives notice that the permit was issued can appeal at any time because only receipt of the notice causes the fifteen-day period to start running.[225] A person aggrieved by a permit's issuance remains aggrieved even though he does not receive notice of its issuance.

Third, the permit applicant may have gained very little by receiving his permit before any appeal may begin. The cautious permittee may decide that construction and operation of his facility prior to a final resolution of the dispute is too risky.[226] Furthermore, a cautious Commissioner may decide to delay the effective date of the permit when a permit's issuance is likely to be appealed.[227] Also, the boards may stay any contested permit provision and any other permit terms that are not severable from the contested provision.[228] If the permit's very issuance is challenged, as in

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[218]*See supra* notes 99-100 and accompanying text.

[219]*See supra* text accompanying note 104 and *Town of Bremen* permit procedure chart (Chart One) at the end of this Note.

[220]*See supra* note 198; Pub. L. No. 143-1985, § 149 (codified at IND. CODE § 13-7-10-2.5(a) (Supp. 1985)).

[221]*See supra* text accompanying note 202.

[222]*Id.* A person will not submit written comments on the question of permit issuance unless he knows it may be issued. Also, a person will not request notice of the permit's issuance unless he had prior knowledge that it may be issued.

[223]*See supra* note 203 and accompanying text.

[224]*See supra* note 204 and accompanying text.

[225]*See supra* text at page 1016.

[226]*See supra* notes 210-11 and accompanying text and *supra* text at page 1021.

[227]*See supra* text accompanying note 201; Pub. L. No. 143-1985, § 149 (codified at IND. CODE § 13-7-10-2.5(e) (Supp. 1985)).

[228]*See supra* text accompanying notes 206-07; Pub. L. No. 143-1985, § 149 (codified at IND. CODE § 13-7-10-2.5(e) (Supp. 1985)).

an objection to the facility's intended location, a board may consider all the permit terms inseverable and stay the entire permit. Thus, the new procedure may have the permittee playing a waiting game, just as he must do in the *Town of Bremen* scheme.[229]

Fourth, when the permit's effective date is delayed, as it is when the Commissioner makes the permit effective on a date later than the date of issuance or when a board stays the entire permit, illegal waste disposal is fostered if no legal disposal method is available.[230] Furthermore, while the appeal is pursued, existing, possibly substandard facilities must remain in use when state-of-the-art facilities are not available.[231]

Fifth, the new procedure is no shorter than the *Town of Bremen* scheme; the *Town of Bremen* procedure has merely been rearranged. Thus, the new procedure may continue to drain the environmental agencies' resources[232] and the citizens' budgets.[233]

Sixth, the new legislation uses the term "person aggrieved"[234] yet fails to define its scope. Thus, the environmental agencies and the courts remain unguided by the legislature as to who has standing to appeal a permit's issuance.[235]

Finally, if the citizens fully exercise their rights under the new procedure, a judge remains the ultimate authority on permit issuances. Thus, judicial decisions may continue to displace the analysis of the technical experts.[236]

The legislature should be commended for its quick action. A little less haste, however, may have produced a more thoughtful solution to the *Town of Bremen* problem. Another reason for this inadequate law may be that the legislature was trying to reconcile two often incompatible interests: the state's interest in promoting industrial development without subjecting that development to undue regulation, and the state's interest in protecting the health and welfare of its citizens and the integrity of its natural resources. The new permit issuance procedure is, nevertheless, as unworkable as the *Town of Bremen* scheme, if not more so.

V. Possible Remedies in the Aftermath of *Town of Bremen* and the 1985 Legislation

Indiana has judicial and legislative options available which, if exercised, would lay to rest the procedural nightmare created by *Town of*

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[229]See *supra* text accompanying notes 189-92 for a discussion of the costs of delay.

[230]*See supra* text at page 1016.

[231]*See supra* and notes 191-92 and accompanying text.

[232]*See supra* notes 185 and 190, and accompanying text.

[233]See *supra* text accompanying notes 189-90 for possible consequences of citizens' budgetary constraints.

[234]*See supra* text accompanying note 204.

[235]*See supra* text accompanying notes 186-88.

[236]*See supra* note 193 and accompanying text.

Bremen and the recent legislative response to that decision. If action is taken soon, the drastic and perhaps unintended consequences of this decision and the new legislative procedure may not come to fruition.

The state could choose to allow the broad grant of citizen standing under *Town of Bremen* to remain intact. The state should, however, fine tune the procedure by implementing a mechanism which joins all objectors in one action at a specific time. The *Town of Bremen* and new legislative procedures allow any person "affected" or "aggrieved" by the permit issuance to halt the orderly permit process if he fails to receive notice by certified mail of the agency's decision to issue the permit.[237] This blockade in the permit procedure contravenes the stated purpose of the AAA.[238]

If broad citizen standing remains, a registry is needed under which all potential affected persons would be required to submit their names and addresses to the agency for notice purposes. This registry should permanently close the class of potential affected persons and thereby preclude the possibility that one stray "affected person" could challenge a permit's validity after the facility has begun to operate. Such a registry mechanism must rigorously require that notice of the potential permit issuance be given by the agency in a manner reasonably calculated to reach all potential affected persons. Otherwise, closure of the class under a registry mechanism will violate the statutory due process rights of those affected persons who do not receive notice.[239]

Although this is not a "remedy," many problems created by *Town of Bremen* would be resolved if the class of persons granted standing under that decision were narrowed judicially. *Town of Bremen* is an appellate decision. An ideal fact situation could cause the Indiana Supreme Court to take a hard look at the *Town of Bremen* court's reasoning. An exemplary case would be an action for judicial review of an air pollution discharge permit for a coal-fired power plant. This suit could be brought by residents in every state that has previously alleged that Indiana's air pollution emissions cause acid rainfall within its borders, and by the Canadian Prime Minister in *parens patriae* for causing acid rainfall in Canada.[240] This action would demonstrate that the scope of citizen standing granted

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[237]*See Town of Bremen*, 458 N.E.2d 672 (Ind. Ct. App. 1984); *supra* text accompanying and immediately following notes 186-88; and *supra* notes 224-25 and accompanying text.

[238]*See supra* text accompanying note 26.

[239]*See Town of Bremen*, 458 N.E.2d 672.

[240]Similar facts have been presented in New York v. Ruckelshaus, No. 84-0853 (D.D.C. filed March 20, 1984). The plaintiffs in that suit include the states of New York, Maine, Vermont, Rhode Island, Connecticut, and Massachusetts. Other plaintiffs include four national environmental organizations. The complaint alleges that the United States Environmental Protection Agency has violated its mandatory duty to require that sulfur dioxide air emissions be reduced in the midwestern states. The complaint further alleges that excessive sulfur dioxide air emissions cause acid rainfall in each of the plaintiff states and in Canada. *Id.*

under *Town of Bremen* should be restricted. It would present a wide range and large number of plaintiffs and thus demonstrate the difficult task an agency has in providing notice of the permit issuance to every conceivable affected person.

Indiana could choose to limit citizen grievances to actions brought under the citizen suit statute.[241] The *Town of Bremen* court did not address the EMB's and Indiana Waste Systems' argument that this provision was the proper mechanism by which the *Town of Bremen* plaintiffs should have asserted their rights.[242] Because the court failed to mention this remedy, it is not likely that the citizen suit statute would be judicially declared the citizen plaintiffs' exclusive remedy. The legislature could, however, make such a declaration. By doing so, a more sensible procedure would displace the *Town of Bremen* and newly-enacted schemes. Under code section 13-6-1-1, the agencies must be given the opportunity to address the alleged problems cited by a citizen complainant.[243] The agencies, as the technical experts, should be afforded the opportunity to explain their permit decisions. The citizen suit provision also requires that the complainant be joined as a party to the agency's investigation and hearing on the complaint.[244] Joinder of the complainant to the agency action allows citizens the right to judicial review of an adverse determination[245] without employing the *Town of Bremen* scheme's circuitous route to the same end. An action maintained under this statute also requires that the petitioner make a *prima facie* showing that the respondent's conduct has polluted the environment or is reasonably likely to pollute it.[246] This re-

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[241] *See supra* text accompanying notes 62-69. Indiana citizens are either unaware of this statute or, alternatively, are choosing not to use it because they find unpalatable the one hundred eighty-day waiting period to maintain an action in court. *See* IND. CODE § 13-6-1-1(b) (1982). To date, there have been only three reported decisions involving suits brought under the citizen suit statute and each was initiated by the same plaintiff. Sekerez v. U.S. Reduction Co., 168 Ind. App. 526, 344 N.E.2d 102 (1976), Sekerez v. Youngstown Sheet & Tube Co., 166 Ind. App. 563, 337 N.E.2d 521 (1975), Sekerez v. U.S. Steel Corp., 316 N.E.2d 413 (Ind. Ct. App. 1974).

[242] Brief for Appellant EMB at 20-22, Brief for Appellant Indiana Waste Systems, Inc. at 16, Appeal from LaPorte Circuit Court, *Town of Bremen*, 458 N.E.2d 672.

[243] IND. CODE § 13-6-1-1(b) (Supp. 1985).

[244] *Id.*

[245] IND. CODE § 13-6-1-1(c) (Supp. 1985).

[246] IND. CODE § 13-6-1-2 (Supp. 1985). When no applicable rule has been violated, the petitioner must also show that no feasible and prudent alternative exists for the allegedly harmful conduct. *Id.* This may be difficult to establish in some cases because landfills are currently among the most cost-effective methods for waste disposal. *See* S. EPSTEIN, M.D., L. BROWN, & C. POPE, HAZARDOUS WASTE IN AMERICA 549 (1982).

Citizens in Connecticut, Michigan, and Minnesota have effectively asserted the environmental rights granted them by state statutes similar in concept to Indiana's citizen suit statute, IND. CODE §§ 13-6-1-1 to -6 (1982 & Supp. 1985). *See* Connecticut Environmental Protection Act, CONN. GEN. STAT. ANN. §§ 22a-14 to -20 (West 1985), *applied in* Manchester Envtl. Coalition v. Stockton, 184 Conn. 51, 441 A.2d 68 (1981); Michigan Environmen-

quirement will eliminate the need to determine whether a person may be "affected" because only those citizens who step forward with their objections will be involved, and will preclude decisions similar to *Town of Bremen* in which the court did not assess the likelihood of pollution. The legislature should require that the agencies give public notice of the potential permit issuance in a manner calculated to reach all persons who might be affected. The legislature should, however, delete the requirement that all potential affected persons be notified by registered mail after the permit is actually issued. This proposed notice mechanism would put the burden on the citizens to determine whether the permit has been issued. This burden is not unreasonable, however, and is warranted because the requirement that all potentially affected persons receive registered mail notice after the permit is issued subjects the permit applicant to unreasonable uncertainty in determining whether the permit he holds is no longer challengeable.

Alternatively, the legislature could enact provisions for a workable, streamlined permit issuance procedure requiring citizen intervention in an orderly fashion, should the legislature choose to allow the same class of persons to have standing as under *Town of Bremen.* A statutory mechanism could be enacted by which the presently available public hearing could be transformed into an adjudicatory hearing upon compliance with specific criteria.[247] The agency would be required to determine whether the criteria are met. Once that determination was made, the agency, permit applicant, and any concerned citizens would have the issue decided in a single administrative proceeding, with full rights to judicial review for both the applicant and citizens. Provision should also be made for expedited judicial review of the agency's decision that the statutory criteria were not satisfied. If the citizens did not prevail, the procedure would end and the permit would be issued. If the citizens were successful on this judicial review, however, the court would only remand the matter to the agency with in-

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tal Protection Act, MICH. COMP. LAWS §§ 691.1201 to .1207 (Supp. 1985), *applied in* West Mich. Envtl. Action Council, Inc. v. Natural Resources Comm'n, 405 Mich. 741, 275 N.W.2d 538 (1979); and Minnesota Environmental Rights Act, MINN. STAT. §§ 116 B.01 to B.13 (Supp. 1984), *applied in* People for Envtl. Enlightenment and Responsibility, Inc. v. Minnesota Envtl. Quality Council., 266 N.W.2d 858 (Minn. 1978).

[247]Wisconsin has such a procedure. *See* WIS. STAT. § 227.064(1)(a)-(d) (1982), *applied in* Town of Two Rivers v. State, 105 Wis. 2d 721, 315 N.W.2d 377 (1981). Under that statute, persons have a right to transform a public hearing into an adjudicatory hearing if:

> (a) A substantial interest of the person is injured in fact or threatened with injury by agency action or inaction;
>
> (b) There is no evidence of legislative intent that the interest is not to be protected;
>
> (c) The injury to the person requesting a hearing is different in kind or degree from injury to the general public caused by the agency action or inaction; and
>
> (d) There is a dispute of material fact.

Id.

structions to conduct the adjudicatory hearing. Chart Three set forth at the end of this Note roughly demonstrates the mechanics of this proposed procedure. If the determination after the adjudicatory hearing is adverse to the citizens, a court, on judicial review, would then have an adequate factual record upon which to base its decision. The court in *Town of Bremen* had no adjudicatory hearing record to review because no such hearing was conducted.

Alternatively, the legislature could enact explicit standing requirements for instituting a judicial review action as an aggrieved person under the AAA. The 1981 Model State Administrative Act contains such a provision:

> (a) The following persons have standing to obtain judicial review of final or non-final agency action:
>
> (1) a person to whom the agency action is specifically directed;
>
> (2) a person who was a party to the agency proceedings that led to the agency action;
>
> (3) if the challenged agency action is a rule, a person subject to that rule;
>
> (4) a person eligible for standing under another provision of law; or
>
> (5) a person otherwise aggrieved or adversely affected by the agency action. For purposes of this paragraph, no person has standing as one otherwise aggrieved or adversely affected unless:
>
> (i) the agency action has prejudiced or is likely to prejudice that person;
>
> (ii) that person's asserted interests are among those that the agency was required to consider when it engaged in the agency action challenged; and
>
> (iii) a judgment in favor of that person would substantially eliminate or redress the prejudice to that person caused or likely to be caused by the agency action.[248]

All three elements of subsection (5) must be met to obtain standing. The determinative element in a *Town of Bremen* situation would be item (i) — whether the agency action has prejudiced or is likely to prejudice the citizen. The drafters of the Act have recognized that the scope of subsection (5) "will ultimately be established by judicial interpretation."[249] Indiana may choose to enact another standard, such as "injury in fact." Regardless of the standard enacted, however, every court would be re-

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[248]MODEL STATE ADMINISTRATIVE PROCEDURE ACT § 5-106, 14 U.L.A. 156 (Supp. 1985).

[249]MODEL STATE ADMINISTRATIVE PROCEDURE ACT § 5-106, Commissioner's Comment, 14 U.L.A. 157 (Supp. 1985).

quired to examine the prejudice or injury alleged before reviewing the challenged agency action. Thus, once the standard is judicially interpreted, the agencies would have guidance in determining which persons may be "aggrieved" by its permit decisions. The *Town of Bremen* decision and the newly-enacted legislative procedure give no such guidance.

The State of Indiana has several routes by which it can repair the damage inflicted by the *Town of Bremen* decision and cure the new procedure's shortcomings. Regardless of the method chosen, a well-considered remedy should be instituted soon. Otherwise, administrative chaos will prevail.

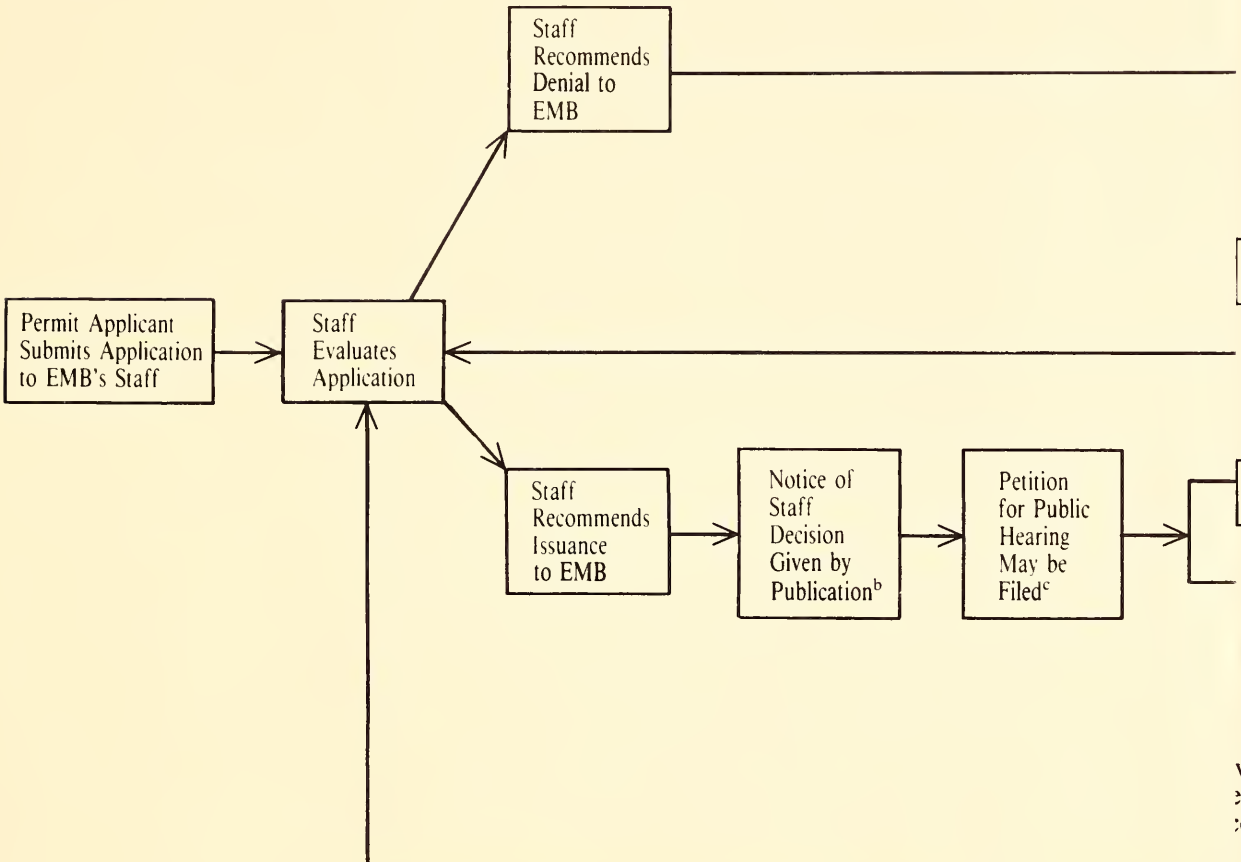
VI. Conclusion

The *Town of Bremen* decision greatly expanded citizens' rights to participate in the licensing of environmentally-related permits. This expansion was not warranted under Indiana's AAA or EMA, however, nor by decisional law. The state must now choose a clear direction and enact efficient procedures to assert the citizen rights granted. The current *Town of Bremen* procedure is too lengthy, too complex, and too expensie to all concerned. The Indiana legislature's recently enacted permit issuance procedure will not solve the existing problems; on the contrary, the new procedure may actually give rise to additional difficulties. The simplest solution may entail a legislative statement that the citizen suit statute is the exclusive remedy available to citizen plaintiffs.[250] Thus, the troublesome "aggrievement" standing test prescribed under the EMA, the AAA, and the unworkable *Town of Bremen* permit issuance scheme would be bypassed without requiring formulation of yet another procedure. The citizen suit mechanism is an orderly and fair method by which citizens may effectively assert their rights in licensing decisions.

Ellen C. Siakotos

[250]For further discussion of this solution, see *supra* text accompanying notes 241-46.

Chart One: The *Town of Bremen* Permit Procedure[a]



a. This chart illustrates the procedure as it applies to EMB-issued permits. The procedure also applies, however, to Air and Stream Pollution Control Board-issued permits except to the extent that IND. CODE § 13-7-10-2 imposes additional procedural requirements on the EMB. *See supra* notes 93-95 and accompanying text.

b. This notice is not explicitly required but is considered an implicit requirement under IND. CODE § 13-7-10-2. *See supra* notes 99-100 and accompanying text.

c. IND. CODE § 13-7-10-2(b).

d. This hearing is mandatory if requested. *Id.*

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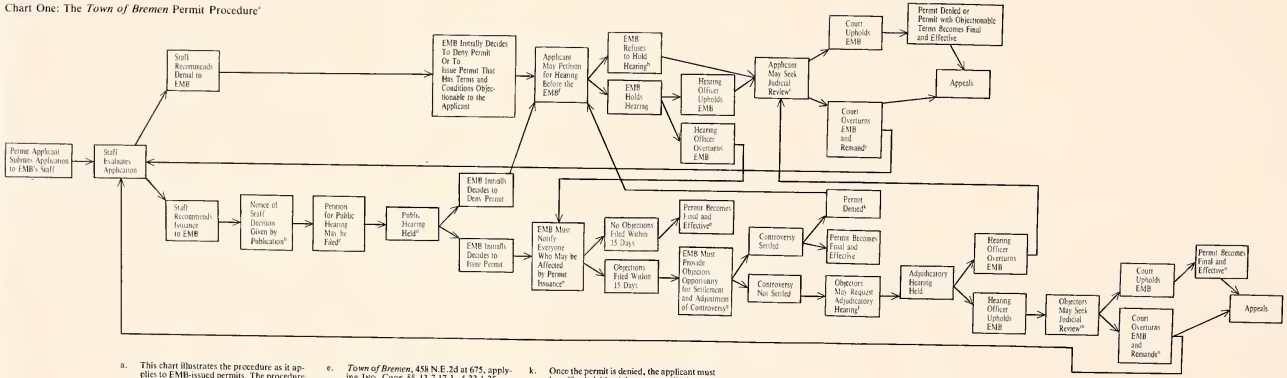

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c. IND. CODE § 13-7-10-2(b).

d. This hearing is mandatory if requested. *Id.*

e. *Town of Bremen*, 458 N.E.2d at 675, applying IND. CODE §§ 13-7-17-1, 4-22-1-25.

f. IND. CODE § 13-7-10-4.

g. IND. CODE § 4-22-1-25.

h. IND. CODE § 13-7-10-4(g).

i. IND. CODE §§ 13-7-10-4, 4-22-1-14.

j. The court may remand but may not issue or deny the the permit. *See Town of Bremen*, 458 N.E.2d at 675-77; *see also* IND. CODE § 4-22-1-18 which states that the court may "remand the case to the agency for further proceedings and may compel agency action unlawfully withheld or unreasonably delayed."

k. Once the permit is denied, the applicant must be afforded his rights to an adjudicatory hearing and judicial review under IND. CODE § 13-7-10-4 and the AAA.

l. Although not explicitly required by *Town of Bremen*, this step necessarily follows under IND. CODE § 4-22-1-25.

m. *Id.*; IND. CODE § 4-22-1-14.

n. *See supra* note j.

o. In showing that the permit becomes effective at this late stage, this chart assumes that the permit does not become effective after the administrative hearing. *See supra* note 112 and accompanying text explaining why this assumption was made.

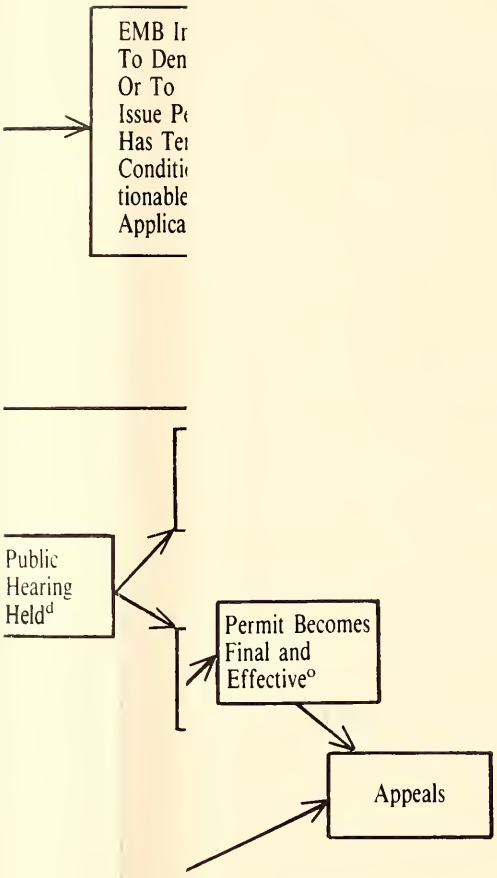

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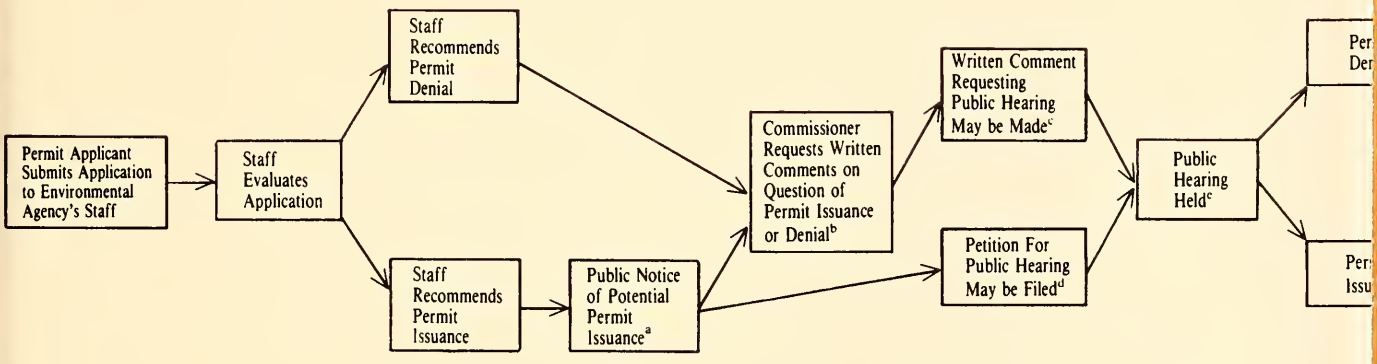
Chart Two: The New Permit Issuance Procedure



a. The new law does not require that this notice be given. *See supra* note 198. The agencies may, however, continue to provide such notice reasoning that it is an implicit requirement of IND. CODE § 13-7-10-2. *See supra* notes 99-100 and accompanying text.

b. This request is discretionary. Pub. L. No. 143-1985, § 149 (codified at IND CODE § 13-7-10-2.5(a)). *See supra* note 198.

c. Pub. L. No. 143-1985, § 149 (codified at IND. CODE § 13-7-10-2.5(a)).

d. IND. CODE § 13-7-10-2(b), *amended by* Pub. L. No. 143-1985, § 148.

e. The hearing requested via written comment need not be held. Pub. L. No. 143-1985, § 149 (codified at IND. CODE § 13-7-10-2.5(a)). The hearing requested by petition must be held. IND. CODE § 13-7-10-2(b), *amended by* Pub. L. No. 143-1985, §148. *See also supra* note 197.

f. The permit is effective im Commissioner states oth 143-1985, § 149 (codifi 13-7-10-2.5(b)). At this p may commence cons operation.

g. Pub. L. No. 143-1985, § 1 CODE § 13-7-10-2.5(b)). *S* panying note 202.

h. Pub. L. No. 143-1985 (co § 13-7-10-2.5(b)). *See su* companying text.

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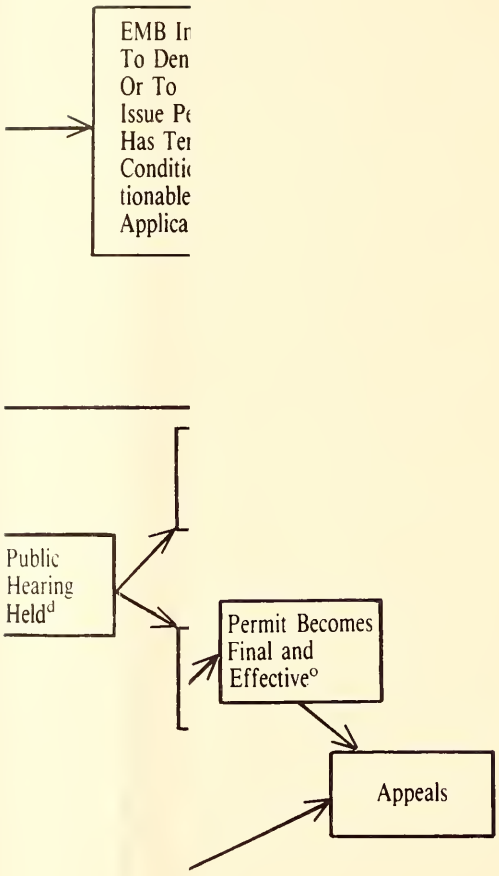

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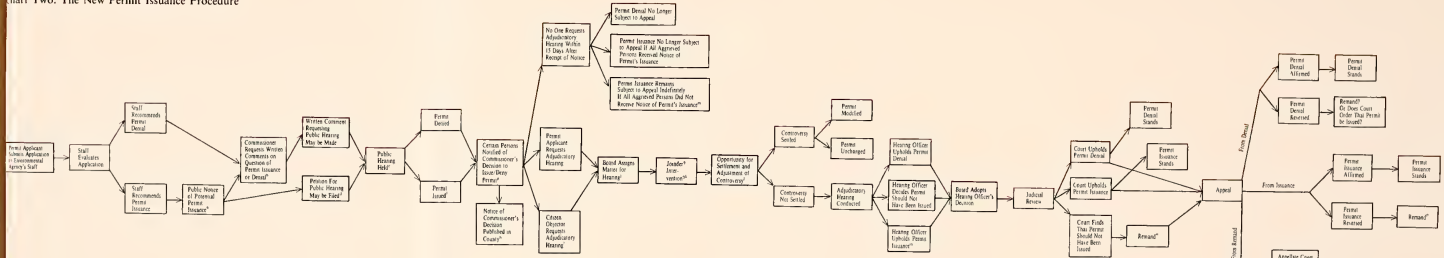

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f. The permit is effective immediately unless the Commissioner states otherwise. Pub. L. No. 143-1985, § 149 (codified at IND. CODE § 13-7-10-2.5(b)). At this point, the permittee may commence construction and/or operation.

g. Pub. L. No. 143-1985, § 149 (codified at IND. CODE § 13-7-10-2.5(b)). *See supra* text accompanying note 202.

h. Pub. L. No. 143-1985 (codified at IND. CODE § 13-7-10-2.5(b)). *See supra* note 203 and accompanying text.

i. A citizen objector may request the hearing if he is a "person aggrieved." Pub. L. No. 143-1985, § 149 (codified at IND. CODE §13-7-10-2.5(c)).

j. At this point, the board may stay the force and effect of any contested permit provision. Pub. L. No. 143-1985, § 149 (codified at IND. CODE § 13-7-10-2.5(c)).

k. If the hearing was requested by a citizen objector, the permittee would be a necessary party to the hearing. If the permit applicant requested the hearing, however, it is unclear whether notice or an opportunity to intervene must be provided to any citizen objectors. IND. CODE § 4-22-1-25.

l. The fifteen day time period for filing an adjudicatory hearing request does not begin to run until notice of the permit's issuance is received. *See* Pub. L. No. 143-1985, §149 (codified at IND. CODE § 13-7-10-2.5(c)) and *supra* text accompanying notes 224-25.

m. The court cannot order that the permit be revoked. *Town of Bremen*, 458 N.E.2d at 675-77; IND. CODE § 4-22-1-18.

n. *Id.*

o. *Id.*

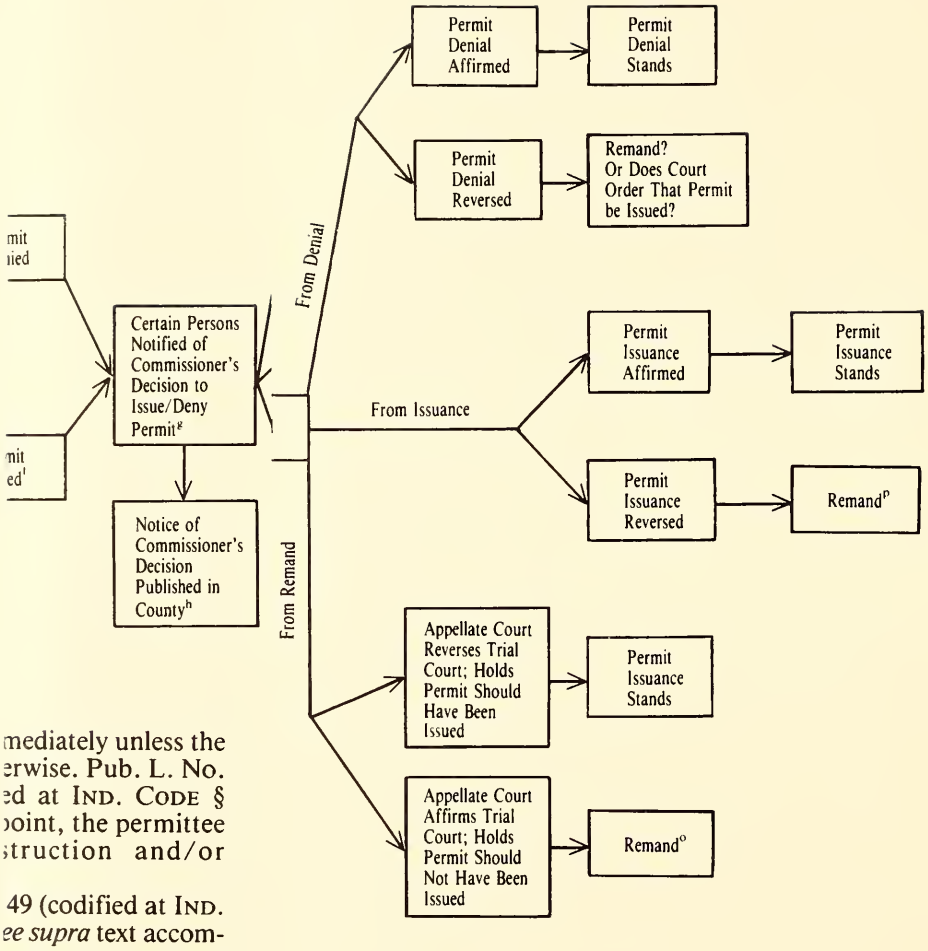

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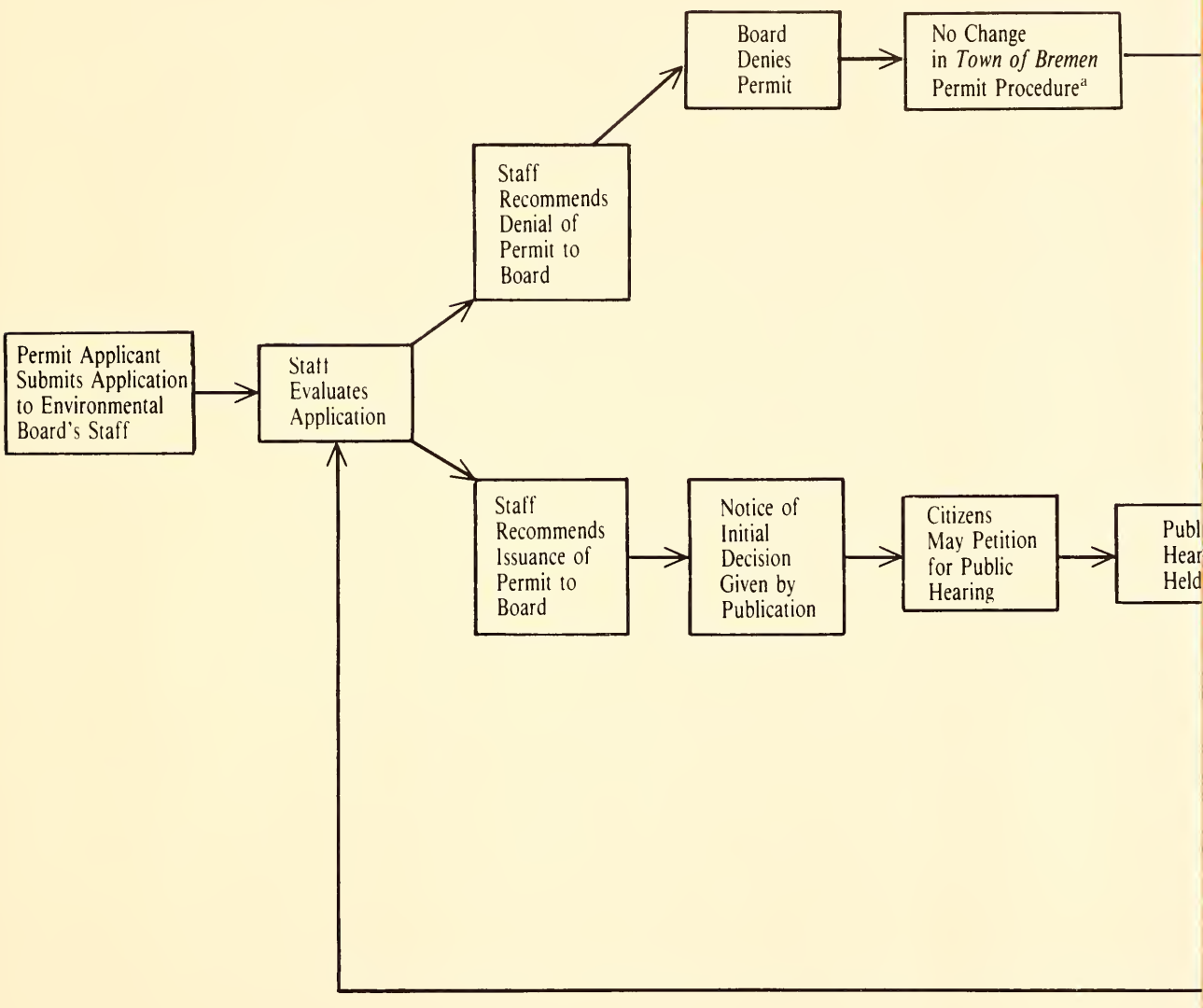
Chart Three: A Possible Remedy—The Hearing Transformation Procedure



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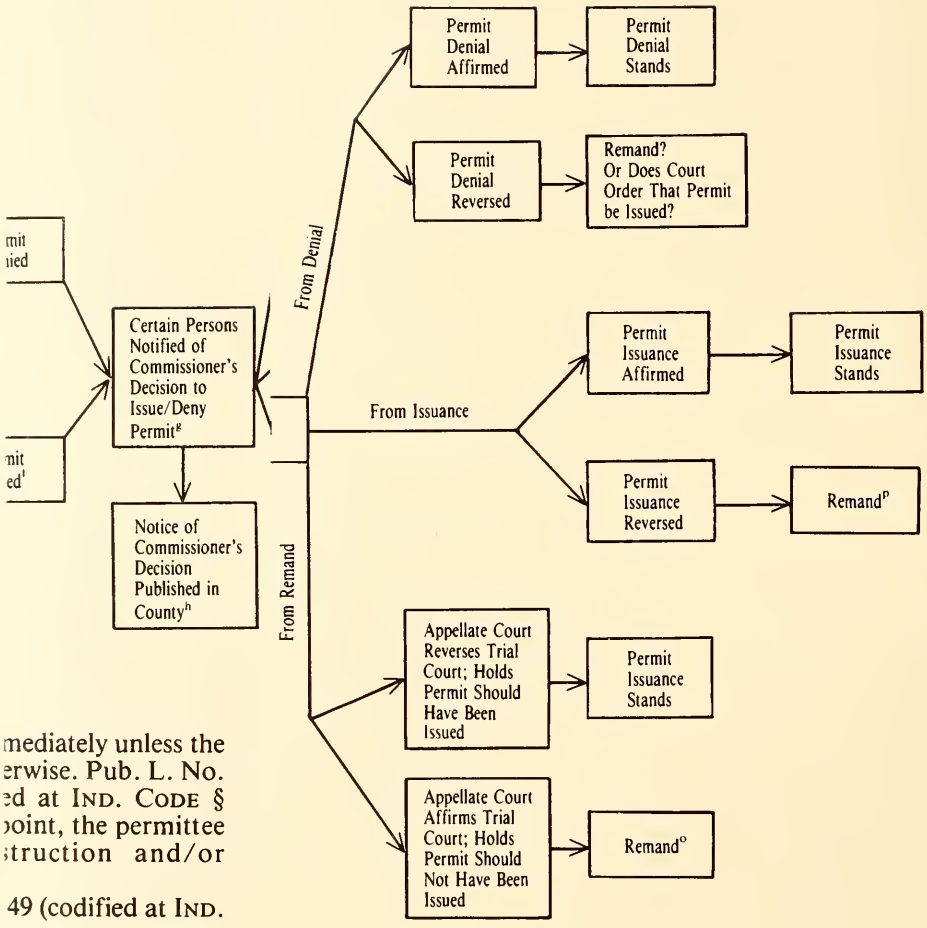
b. *See supra* note 247 and accompanying text.



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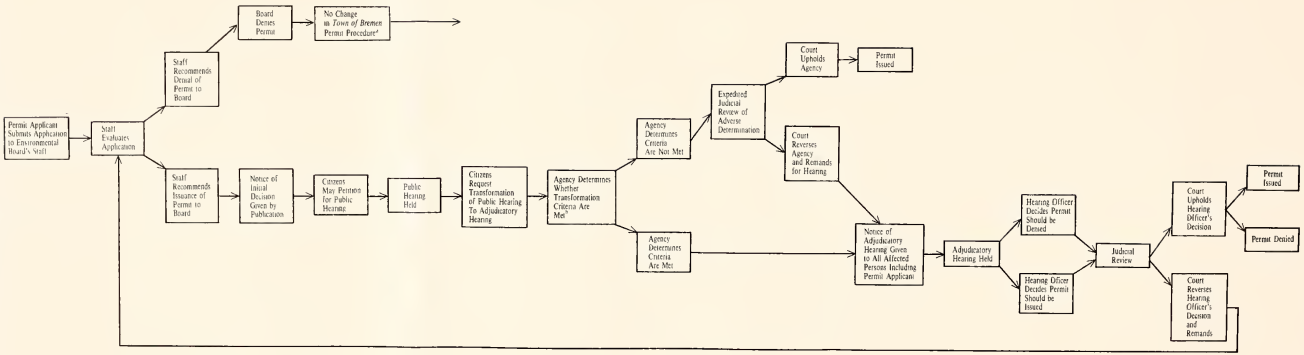

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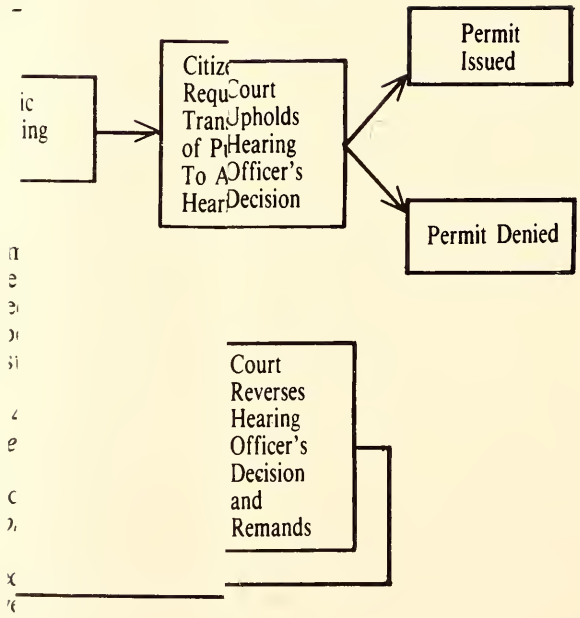
Permit Issued
Court Upholds Hearing Officer's Decision
Permit Denied
Court Reverses Hearing Officer's Decision and Remands

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